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Supreme Court of the United States

October, 1955 Term

No. 358

DAVID L. SUBIN,

Petitioner,

—v.—

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & Co., a New York Corporation.

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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To the Chief Justice of the United States and the Associate Justices of the United States Supreme Court:

Petitioner respectfully asks this Court to issue a Writ of Certiorari to review so much of the judgment of the United States Court of Appeals for the Second Circuit as affirmed a judgment in the United States District Court for the Southern District of New York dismissing Counts I and III of the amended complaint which charged violations of the Securities Exchange Act of 1934, and Rule X-14A-9 of the Securities and Exchange Commission.

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(a) The Opinions Below

The opinions of the Court below have not yet been officially reported. Copies are hereto annexed. (See pages 14 to 56, *infra.*)

(b) Statement of Grounds of Jurisdiction

1. The judgment of the Court of Appeals was rendered and entered on June 3, 1955.

2. No application for rehearing was made.

3. The jurisdiction of this Court is invoked pursuant to the provisions of 28 U. S. C., Section 1254.

(c) Questions Presented for Review

1. May the controlling directors of a registered corporation, soliciting stockholders' approval of a transaction between the corporation and themselves and companies controlled by them, omit from a proxy statement facts from which stockholders might reasonably infer that the directors had personal ulterior motives in negotiating and recommending the transaction.

2. Can a Court determine as a matter of law and without a trial that a proxy statement did not contain false and misleading statements and did not omit material facts necessary to make representations therein not misleading, despite allegations of a complaint that statements therein were false and misleading and that there were omissions of material facts necessary to make representations therein not misleading.

(d) Statutes and Regulations Involved

The statutes and regulations involved are as follows:

Section 14(a), Securities Exchange Act of 1934 (Title 15 U. S. C. §78n(a)):

> "(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule X-14A-9, Securities and Exchange Commission (17 C. F. R. 240.14a-9). "False or Misleading Statements":

> "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

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(e) Statement of the Case

The amended complaint alleges (Counts I, III) that the individual respondents, directors of the corporate respondent Julius Kayser & Co. (hereinafter referred to as "Kayser") distributed a proxy statement in violation of Section 14a of the Securities Exchange Act of 1934 and Rule X-14A-9 of the Securities and Exchange Commission. It is also alleged (Count V) that the transaction for which stockholders' approval was solicited, constituted an improper and wasteful expenditure of corporate funds.

The Court below affirmed a judgment of the District Court dismissing Counts I—IV for failure to state a claim for relief (Judge Frank dissenting as to Counts III and IV) and reversed summary judgment dismissing Count V (Judge Medina dissenting). A Writ of Certiorari is sought to review so much of the judgment below as affirmed the dismissal of Counts I and III.

Count I (4-13),* is pleaded as a representative cause of action brought by plaintiff, a stockholder of Kayser, on behalf of himself and all other stockholders. Count III (14) repleads the same allegations in a derivative cause of action brought on behalf of respondent "Kayser."

Respondent Kayser is a New York corporation whose capital stock is registered on a national securities exchange (4). On May 13, 1954 a controlling bloc of the capital stock of Kayser (32.2%) was purchased by three corporations controlled by respondents Goldsmith, Feinberg and Hinerfeld from four directors of Kayser and

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* References are to petitioner's appendix in the Court below.

from a corporation whose chairman of the Board was also chairman of Kayser's Board (5).

The chairman of the Board of Directors of Kayser and four directors resigned; and the surviving directors elected respondents Goldsmith, Feinberg, Hinerfeld and three other persons as directors (5).

Less than two months later, the Board of Directors of Kayser, dominated by Goldsmith, Feinberg and Hinerfeld (5), approved a contract between Kayser and one of its three controlling stockholders, Diamond Hosiery Corporation, which latter company was controlled by defendant Goldsmith (6). The contract (15a-29a)** provided that Kayser purchase buildings, equipment and inventory from Diamond Hosiery Corporation for approximately $1,750,000 and that Kayser assume various of Diamond's obligations and leases for buildings and equipment. By a notice (18) dated July 22, 1954 a special meeting of Kayser's stockholders was called to approve the transaction. At the same time defendants distributed a proxy statement (19-36) which solicited proxies in favor of the sale. The statement advised stockholders that the transaction would not be consummated unless the holders of a majority of Kayser's stock approved (27); and the contract itself provided that either party might terminate if such approval were not forthcoming (26a).**

It was alleged that the proxy statement failed to disclose that the three corporations controlled by respondents Goldsmith, Feinberg and Hinerfeld had made loans in order to finance their purchase of the controlling bloc of

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** Respondents' appendix in Court below.

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Kayser's stock and that the cash to be paid by Kayser to Diamond would be used to repay these loans (8-10).

It was also alleged that another purpose of the transaction was to provide Diamond with funds to repay moneys owed by it to another corporation affiliated with Feinberg and Hinerfeld and with Hamilton Hosiery Mills, one of the three controlling corporate stockholders of Kayser (8).

The amended complaint also alleged that the proxy statement was defective in that it did not disclose to the stockholders that the individual defendants purchased their stock from directors of Kayser who had resigned (10); and that the proxy statement omitted material information concerning the financial condition and operations of defendant Kayser and of Diamond Hosiery Corporation, which the stockholders required in order to make an informed decision concerning the transaction (10-12).

The District Court was of the opinion that the disclosures of the proxy statement were adequate with respect to the loans (40-42). Judge Walsh declared that these disclosures

> "gave a fair and complete statement of the proposed transaction. They put the stockholders on notice as to the possible conflict of interest of the directors. Plaintiff could have obtained such further information as he was entitled to as a stockholder but he made no inquiry" (41).

In his opinion (pp. 45 to 56, *infra*) for the majority of the Court below, Judge Medina stated that it was

> "at least doubtful that it was the intention of the Congress to create any substantive rights by the

> provisions of Section 14(a) and 29(b) of the Security Act'' (at p. 47, *infra*).

But he declared that it was not necessary to determine that point since the allegations of Counts I—IV were insufficient to state a claim for relief. Judge Medina held that the omission which was principally relied upon was that concerning the loans made to finance the purchase of the controlling bloc of Kayser's stock. He found that the amended complaint did not directly allege that the loans had been made and that the District Court properly held that the allegations were insufficient in law on their face because

> ''otherwise a speculator or competitor interested in muddying the waters could attack any substantial proposed transaction, without knowing anything about it'' (p. 51, *infra*).

Judge Frank dissented as to Counts III and IV (pp. 32 to 44, *infra*). He concluded that the complaint adequately pleaded the failure to make a disclosure of the loans and the fact that the purchase price would be used to repay them. Judge Frank was of the opinion that the failure of the proxy statement to make ''any mention whatever of the facts about the loans'' rendered it violative of Section 14(a) of the Act and the Commission's proxy rule; and that because three of the individual respondents controlled Kayser, they owed a fiduciary obligation to its other stockholders; and that this obligation and the requirements of the Securities Exchange Act of 1934 made the omitted information concerning the loans plainly material (pp. 39, 40, *infra*).

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Judge Frank agreed with the majority that the other allegations concerning the proxy statement did not make out a good cause of action.

(g) Jurisdiction of the Court Below

The District Court had jurisdiction under 15 U. S. C. 78(aa). The Court of Appeals had jurisdiction under 28 U. S. C. 1291.

(h) Reasons Relied On

As to Question 1

The Court below has decided an important question of federal law affecting the Securities Exchange Act of 1934 and rules promulgated thereunder by the Securities and Exchange Commission which has not been, but should be, settled by this Court. *Wilko* v. *Swann*, 346 U. S. 427, 430. Moreover, in deciding this question the Court below failed to apply a principle applied in previous decisions of this Court. Cf. *Pepper* v. *Litton*, 308 U. S. 295, 306.

The amended complaint alleged that one purpose of the proposed transaction between respondent Kayser and Diamond Hosiery Corp. was to provide funds whereby the individual respondent directors Goldsmith, Feinberg and Hinerfeld and the three corporations which they controlled could pay loans previously made to finance the purchase by them of a controlling bloc of Kayser's stock. The proxy statement made no reference to the loan or the use of the purchase price to repay it. Judge Frank thought that this omission

> "rendered the proxy statement violative of Section 14(a) of the Act and the SEC proxy rule" (p. 39, *infra*).

From the facts thus omitted, stockholders of Kayser might well have inferred that the transaction was being undertaken to benefit the dominating Kayser directors and the corporations controlled by them and that the best interests of Kayser were not served. Were the stockholders entitled to the information from which such an inference could have been drawn?

The Securities and Exchange Commission has stated that each stockholder should be furnished

> "such information as will enable him to act intelligently upon each matter in respect of which his vote or consent is sought" (SEC 15th Annual Report, 1949, p. 48).

Moreover, Rule X-14a-9 prohibits solicitation by proxy statements which contain any statement that is false and misleading with respect to material facts or which omits material facts necessary to make the contents of the proxy statement not false or misleading .

The proxy statement contained a description of the amount of Kayser's stock (32.2%) held by three corporations, which are, in turn, controlled by respondents Goldsmith, Feinberg and Hinerfeld; and a description of the directorships and offices held by each of these respondents in Kayser and in their three controlled companies. The proxy statement represented that this was a complete description of the interests which the directors and the controlling stockholders had in the transaction. As Judge Frank noted, this representation was false.

The logical consequence of the opinion below, in so far as interest is concerned, is that stockholders are only en-

titled to know how much stock directors own and what offices they hold. For certainly the respondent directors and the controlling stockholders had an interest in the transaction far greater than an increase in the value of the stock which they held. Their interest was in securing the completion of a transaction whereby they acquired control of a registered corporation with borrowed funds. To do this they intended to use cash procured from Kayser to pay off the loan. Such a situation obviously can create far greater pressure upon directors to carry out a transaction with their corporation than mere ownership of a substantial bloc of stock; and also to issue a "persuasive" proxy statement. Yet the Court below found that the facts concerning such sources of pressure are not material and that the omission of these facts does not make false and misleading a representation that directors have fully disclosed their interest.

Apparently the Court below considered that motives, or facts from which motives could be drawn, need not be presented to the stockholders. But directors' purposes and motives, and facts from which they may be inferred, are as relevant as balance sheets and financial statements. If this were not so, there would be no purpose in requiring even a disclosure of the amount of stock held by interested parties to the transaction. It is all the more so here, since little factual information was actually provided to stockholders. For example, the only financial statements made available to stockholders were an unaudited balance sheet of Kayser for the period ending May 31, 1954 and related statement of earnings and surplus and unaudited financial statement of Diamond Hosiery Corp. as of February 28, 1954, months prior to the transaction in question.

Also involved here is the applicability of the rule announced by this Court in *Pepper* v. *Litton*, 308 U. S. 295 that where directors deal with their own corporation the burden is on them

> "not only to prove the good faith of the transaction, but also to show its inherent fairness from the viewpoint of the corporation and those interested therein" (at p. 306).

See also:

Geddes v. *Anaconda Mining Co.*, 254 U. S. 590, 599;

Sage v. *Culver*, 147 N. Y. 241, 247;

Munson v. *Syracuse G & RR Co.*, 103 N. Y. 358;

Globe Woolen Co. v. *Utica Gas & Electric*, 224 N. Y. 483.

This burden of disclosure and proof of good faith should be met in a proxy statement. We respectfully submit that the Court below failed to recognize that the transaction was one between "Kayser" and its dominating directors and three companies which they control (which, in turn, were the controlling stockholders of Kayser)—and not one with strangers.

The extent of disclosure in these circumstances should be greater than might have been required in an ordinary arm's length business transaction. But the Court below has adopted such a narrow standard as to vitiate the doctrine announced in *Pepper* v. *Litton*, 308 U. S. 295 and to render the proxy rules useless as an instrument for protecting stockholders. The good faith of the transaction could not be proven or explained by the directors

without a description and explanation of the loan transaction.

As to Question 2

The second question is also an important one of federal law affecting the Securities Exchange Act of 1934 and rules promulgated thereunder by the Securities and Exchange Commission. This question has not been, but should be, settled by this Court.

The complaint alleged, and by the motion to dismiss it was admitted (*Collins* v. *Hardiman*, 341 U. S. 651), that certain statements in the proxy statement were false and that the proxy statement omitted facts required to make statements therein contained not false or misleading. Aside from the matter of the loans, which is treated in Question No. 1 above, Judge Frank concurred with the other members of the Bench below in holding that the complaint failed to state a claim for relief.

Since there is no fixed standard by which there can be judged the relevance of specific facts or categories of information to multitudinous and varying business transactions, it is difficult if not impossible for a court to determine on the face of a complaint whether any fact or group of facts were relevant to the representations in a proxy statement and would or would not tend to make them false. It is respectfully submitted that the cases cited by Judge Frank with respect to the propriety of petitioner's pleading on the question of loans applied with equal force to the questions involved here (pp. 36, 37), *infra*).

Conclusion

It is respectfully submitted that the questions raised are of such importance in the Administration of the Securities Exchange Act of 1934 that there should be an authoritative determination of same by this Court. Accordingly, petitioner asks that this Court issue a writ to review the judgment of affirmance as to Counts I and III of the amended complaint herein.

Respectfully submitted,

Osmond K. Fraenkel,
Counsel for Petitioner.

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Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Calendar No. 198—October Term 1954

Argued February 15, 16, 1955 Decided June 3, 1955

Docket No. 23348

DAVID L. SUBIN,

Plaintiff-Appellant,

—v.—

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & Co., a New York Corporation,

Defendants-Appellees.

Before:

FRANK and MEDINA, *Circuit Judges*, and BRENNAN, *District Judge*.

Appeal from a judgment of the United States District Court for the Southern District of New York, entered by Judge Walsh. Affirmed in part; reversed and remanded in part.

HAYS, ST. JOHN, ABRAHAMSON & SCHULMAN (Osmond K. Fraenkel, Seymour M. Heilbron, David W. Niesenbaum and Irwin Karp, of counsel) *for plaintiff-appellant;*

FERRIS, ADAMS & CREIDY, *for appellee Goldsmith;*

Opinion

GAINSBURG, GOTTLIEB, LEVITAN & COLE, *for appellees, Feinberg and Hinerfeld;*

PARKER, CHAPIN AND FLATTAU, *for appellees, Mueller et al.;*

ALVIN MCK. SYLVESTER, SAMUEL GOTTLIEB, GEORGE A. FERRIS AND JOSEPH LEVY (of counsel).

FRANK, *Circuit Judge*:

Plaintiff, a stockholder of defendant Julius Kayser & Co., filed a complaint on August 12, 1954, seeking an injunction against that company and the individual defendants who are its directors, from holding a stockholders' meeting to be held on August 20, 1952, to approve a contract for the purchase by Kayser of most of the assets of Diamond Hosiery Corp. Plaintiff moved for a preliminary injunction; the judge denied the motion. The stockholders' meeting was held and there the contract was approved by holders of a majority of the shares. Plaintiff then filed an amended complaint. A copy of that amended complaint is set forth in the Appendix to this opinion.

The amended complaint contained five counts. The first four allege violations of a federal statute. Count V alleges a non-statutory wrong. On defendants' motions, the judge dismissed Counts I, II, III and IV for failure to state causes of action, and entered summary judgment dismissing Count V. Plaintiff has appealed.

All three members of this panel of the court agree on affirmance as to the dismissal of Count II. Judge Brennan and I agree that there must be a reversal as to Count V; Judge Medina dissents in this respect, for reasons stated

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in his separate opinion. For reasons also stated in Judge Medina's opinion, a majority of this panel holds that the judgment of dismissal of Counts I, III and IV must be affirmed. For reasons I shall state below, I agree as to Count I. But I dissent as to Counts III and IV for reasons stated in a separate opinion infra. It is convenient to begin with Count V.

1. COUNT V.

Count V is a derivative claim on behalf of defendant Kayser & Co. Through incorporation by reference of other parts of the complaint, it sufficiently alleges (1) diversity of citizenship and the necessary jurisdictional amount, (2) that plaintiff was a shareholder at the time of the transaction of which he complains, (3) that the action is not collusive, and (4) that it would have been futile to make a demand upon the Board of Directors to bring the suit.[1] These allegations satisfy the jurisdictional requirements and F.R.C.P. 23(b).

It further alleges that the Kayser company, on July 22, 1954, entered into a contract with Diamond Hosiery Corporation for the purchase by Kayser of the assets of Diamond; that this contract was made "at the instigation

1. This Count does not specifically allege that the suit is on behalf of the Kayser Company. But it makes allegations required by Rule 23(b) only in cases of a stockholders' derivative action, and therefore, by plain implication, is derivative. Moreover, defendants, neither in the district court nor in this court, argued any deficiency on that score, nor did the district judge mention it; accordingly, if this omission were important, plaintiff should be permitted to amend to that extent.

and direction of" defendants Goldsmith, Feinberg and Hinerfeld, who are directors of Kayser; that these three defendants dominate and control the Kayser Board of Directors and its management, through their control of three companies, Diamond, Hillcrest and Hamilton, which together are the controlling stockholders of Kayser (so that Goldsmith, Feinberg and Hinerfeld thus control both the buyer and seller under the Kayser-Diamond contract); that the purchase by Kayser of the Diamond assets will constitute an improper and wasteful expenditure of Kayser's funds which will be detrimental to it and will be solely for the benefit of Goldsmith, Hinerfeld and Feinberg; that the Diamond assets are not needed by Kayser and are not worth the price paid for them; and that the contract imposes on Kayser a burdensome lease, the lessor under which is a company in which Goldsmith, Feinberg and Hinerfeld have a large interest.

Those allegations state a valid derivative action. See, e.g., Pepper v. Litton, 308 U. S. 295, 306; Sage v. Culver, 197 N. Y. 241, 247; Perlman v. Feldman, 219 F. (2d) 173 (C.A. 2). We see no reason why greater particularity of allegations should be required in a stockholders' derivative action than in many another sort of action such as, e.g., one for accounting, or for treble damages because of an anti-trust law violation, as to which see, e.g., Package Closure Corp. v. Sealright Co., 141 F. (2d) 972, 978 (C.A. 2).

Defendants did not move for dismissal of this Count for failure to state a cause of action. They did move for summary judgment. The judge granted their motion. We think he erred.

In support of their motion, defendants introduced four affidavits.[3] Two of them were by defendants' lawyers; so far as they bear at all on Count V, they were not based on "personal knowledge," and therefore do not suffice under F.R.C.P. 56(e).[4] A third affidavit, by an accountant, contained nothing which related in any way to this Count.

The fourth affidavit was that of defendant Feinberg, only a portion of which related to this Count. That portion consists of his opinion and his statements about the views of the other directors. If at a trial he were to testify, his opinion as a director would be admissible. But, without evidence of the views of the other directors, his opinion alone would not support a directed verdict, or judgment, for the defendants; nor would his testimony concerning their views, since such testimony would be hearsay and consequently not "competent" evidence.[5] Therefore his affidavit was insufficient under F.R.C.P. 56(e).

Even if, however, we disregarded that objection, Feinberg's affidavit could not support the summary judgment. The pertinent facts of that affidavit are as follows: The Kayser directors believed and decided that the acquisition

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3. Three of these affidavits had been presented previously in opposition to plaintiff's motion for a preliminary injunction.

4. Rule 56(e) requires that affidavits, on a summary judgment motion, "shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that affiant is competent to testify to the matters stated therein."

5. See, e.g., Jameson v. Jameson, 176 F. (2d) 58, 60 (App. D.C.); United States v. Britten, 161 F. (2d) 921, 928 (C.A. 3); cf. Automatic Radio Co. v. Hazeltine, 339 U. S. 827, 831.

of the Diamond business would benefit Kayser. Among the benefits were these: There would result a 50% increase in the gross business of Kayser interests; the addition of the Diamond business will treble Kayser's volume of hosiery business; Kayser will obtain the services of Goldsmith who has been outstandingly successful in the hosiery business; Kayser will acquire an excellent merchandising and selling organization; the addition of the Diamond business will round out the line of Kayser's products; Feinberg estimates conservatively that the absorption of the Diamond business will make possible savings which will add a minimum of $700,000 to Kayser's annual earnings before taxes, and this figure should go higher when overlappings of the two organizations are eliminated as the directors are confident they will; Kayser will get the benefit of some $500,000 of unfilled orders. We shall assume, arguendo, that Feinberg's affidavit, if taken as true, completely controverted the allegations of Count V. But we have held that, in such a derivative stockholders' suit—especially as to facts peculiarly within the knowledge of the defendants—plaintiff is entitled to a trial at which he may cross-examine the defendants and at which the trial judge can observe their demeanor in order, thereby, to evaluate their credibility.

See Fogelson v. American Woolen Company, 170 F. (2d) 660 (C.A. 2). It was a derivative suit seeking to enjoin the company and its directors from carrying out a proposed pension plan. The defendant company moved for a summary judgment. In support of the motion, it filed the affidavits of all the directors, in which each swore that he had participated in the decision of the Board of Direc-

tors and had done so because he thought it for the best interest of the company; these directors, who made such affidavits, included a former Governor of Massachusetts, a former Governor of the Federal Reserve Board, a former Assistant Secretary of the Treasury.[6] The trial judge granted the motion on the ground that these affidavits showed an exercise of judgment by the Board of Directors with which a court should not interfere. See 79 F. Supp. 291. We reversed, saying, per Judge Swan[6a] (170 F. (2d) at 662): "Courts are properly reluctant to interfere with the business judgment of corporate directors; they do so only if there has been so clear an abuse of discretion as to amount to legal waste. See McQuillen v. National Cash Register Co., 112 F. (2d) 877, 884 (C.A. 4), cert. den. 311 U. S. 695. In setting up a retirement pension plan, the decision of the directors to fund past service benefits by a single lump-sum payment rather than by installment payments over a term of years, will normally be conclusive. So also will their decision as to the desirability of applying a percentage formula uniformly to all employees' salaries without imposing a limitation in dollars upon the maximum pension payable to high salaried officers. In the case at bar the adoption of these features results in giving the president an annual pension for life of more than $54,000 a year while the employee receiving the next largest pension will receive only $7,285. The complaint alleges that the very purpose of the proposed lump-sum payment to a pension trustee is to secure to the president his large

6. See Transcript of Record, pp. 57-72.

6a. The court consisted of Judges Learned Hand, Swan and Chase.

pension free from the hazard of future business vicissitudes to which the corporation will be subject. This allegation is denied by the answer, and the denial is supported by affidavits of the directors that each director who voted for the plan exercised his best business judgment. But this denial would be refuted if the plaintiff were able to prove that the real purpose was as alleged. Therefore a triable issue of fact exists as to whether the directors did exercise their honest business judgment or were motivated by the alleged purpose of favoring the president. It may be unlikely that the plaintiffs can prove their allegation, for such proof must be drawn largely from the directors themselves by cross-examination; but we do not think that their affidavits must be accepted as conclusive and thus preclude any trial of that issue. See Arnstein v. Porter, 154 F. (2d) 464, 469-471 (C.A. 2); Winkelman v. General Motors Corp. D.C.S.D.N.Y., 39 F. Supp. 826, 835."

In Bozant v. Bank of New York, 156 F. (2d) 787, 790 (C.A. 2), we said (per Judge Learned Hand):[7] "In conclusion we cannot avoid observing that the case is another mistaken effort to save time by an attempt to dispose of a complicated state of facts on motion for summary judgment. This is especially true when the plaintiff must rely for his case on what he can draw out of the defendant. Arnstein v. Porter, 2 Cir., 154 F. (2d) 464. It appears to be somewhat difficult to persuade the district courts of this; but we are satisfied that it is true." In Colby v. Klune, 178 F. (2d) 872, 873-875 (C.A. 2), reversing a sum-

7. The court consisted of Judges Learned Hand, Swan and Chase.

mary judgment for defendants, we said:[8] "For the affidavits do not supply all the needed proof. The statements in defendants' affidavits certainly do not suffice, because their acceptance as proof depends on credibility; and—absent an unequivocal waiver of a trial on oral testimony—credibility ought not, when witnesses are available, be determined by mere paper affirmations or denials that inherently lack the important element of witnesses' demeanor. As we observed in Arnstein v. Porter, 2 Cir., 154 F. (2d) 464, 471: 'It will not do, in such a case, to say that, since the plaintiff, in the matter presented by his affidavits, has offered nothing which discredits the honesty of the defendant, the latter's deposition must be accepted as true.' For the credibility of the persons who here made the affidavits is to be tested when they testify at a trial. Particularly where, as here, the facts are peculiarly in the knowledge of defendants or their witnesses, should the plaintiff have the opportunity to impeach them at a trial; and their demeanor may be the most effective impeachment. Indeed, it has been said that a witness' demeanor is a kind of 'real evidence'; obviously such 'real evidence' cannot be included in affidavits. In Sartor v. Arkansas Natural Gas Corp., Kansas Group, 321 U. S. 620, 628, 64 S. Ct. 724, 729, the Court said that a summary judgment may not be used to 'withdraw these witnesses from cross-examination, the best method yet devised for testing trustworthiness of testimony'; the Court, in that connection, quoted with approval from Aetna Life Insurance Co. v. Ward, 140 U. S. 76, 88, 11 S. Ct. 720, 724:

8. The court consisted of Judges Learned Hand, Swan and the writer of the present opinion.

'There are many things sometimes in the conduct of a witness upon the stand, and sometimes in the mode in which his answers are drawn from him through the questioning of counsel, by which a jury are to be guided in determining the weight and credibility of his testimony.'

"Nor is the situation different because the trial will be before a trial judge without a jury. For how can the judge know, previous to trial, from reading paper testimony, what he will think of the testimony if and when, at a trial, he sees and hears the witnesses? It is because of the crucial element of demeanor-observation that a trial judge's findings are usually binding unless 'clearly erroneous'; his findings have not that effect when he has not observed the witnesses.

"'All manner of expedients,' says Dean Pound, 'have been resorted to * * * to arrive at a written settlement of the facts not dependent on the credit to be accorded witnesses or the impression they may make on the particular trial court. * * * But experience has shown that we cannot be sure that in getting a clear-cut statement of facts in this way, to which the law may be applied, we are not cutting out too much, so in the end to be trying an artificial case instead of the real controversy.'

"It may happen (although we do not know) that, because of their unavailability at the trial, plaintiff will be obliged to obtain the testimony of some or all of the defendants' witnesses by deposition. If so, the demeanor-aspect of their testimony will be lost; however, he will at least have the chance to cross-examine them, an opportunity he has not yet had."

See Toebleman v. Missouri-Kansas Pipe Line Co., 130 F. (2d) 1016, 1022 (C.A. 3), a stockholders' derivative action: "It is obvious that this evidence must come largely from the defendants. This case illustrates the danger of founding a judgment in favor of one party upon his own version of facts within his sole knowledge as set forth in affidavits prepared ex parte. Cross-examination of the party and a reasonable examination of his records by the other party frequently bring forth further facts which place a very different light upon the picture."

In Laudermilk v. Fidelity & Casualty Company of New York, 199 F. (2d) 561, 565 (C.A. 5), it was said: "This is not the kind of case that can be settled on summary judgment. It is peculiarly the kind of case where the triers of fact whose business it is not only to hear what men say but to search for and find the roots from which the sayings spring, should be afforded full opportunity to determine the truth and integrity of the case. Cf. Gray Tool Co. v. Humble Oil & Refining Co., 5 Cir., 186 F. (2d) 365, at page 367; Colby v. Klune, 2 Cir., 178 F. (2d) 872, 873." See also Sarnoff v. Ciglia, 165 F. (2d) 167, 168 (C.A. 3); Dulansky v. Iowa-Illinois Gas & Electric Co., 191 F. (2d) 881, 883-884 (C.A. 8); Avrick v. Rockmount Envelope Co., 155 F. (2d) 568, 571, 573 (C.A. 10); Lane Bryant v. Maternity Lane, Ltd., 173 F. (2d) 559, 564-565 (C.A. 9).

An opponent's failure to file counter-affidavits does not in this kind of case compel acceptance as true of facts alleged in the movant's affidavits. In Albert Dickenson v. Mellos Peanut Co., 179 F. (2d) 265, 268 (C.A. 7), the court

said: "It is undoubtedly a somewhat hazardous course of procedure on a motion for summary judgment for the adverse party not to file an answering or opposing affidavit in support of his motion. However, we do not think an inflexible rule should be established that in every case the adverse party be penalized right out of court for not filing an opposing affidavit * * * v. * * * *" See also Griffith v. William Penn Broadcasting Co., 4 F.R.D. 475 (D.C.E.D. Pa.) ("Defendant's failure to file a counter affidavit to support its opposition to the motions is of no significance."); Bowdle v. Automobile Ins. Co. of Hartford, 99 F. Supp. 161 (D.C. Del.).

There are cases where facts stated in a movant's affidavits or exhibits (e.g., that a certain document was executed on a stated date) should be taken as true, unless controverted in the opponent's affidavits, as, e.g., where the contrary facts are peculiarly within the opponent's knowledge, or where they can be developed by his own investigation rather than by cross-examination: In Dixon v. American Tel. & Tel. Co., 159 F. (2d) 863 (C.A. 2), plaintiff sued for review of an earlier adverse judgment. Defendants pleaded laches in failure to sue more promptly and moved for summary judgment. Plaintiff by affidavit alleged facts, e.g., illness, which might have satisfactorily explained part of his delay, but which did not cover the entire period during which he had delayed. All facts pertaining to laches—e.g., alleged incompetency of plaintiff's attorneys in the earlier suit, sickness, etc.—were exclusively within plaintiff's knowledge. No additional facts could have been developed and exposed by plaintiff through

cross-examination of defendants. His failure, then, to allege facts sufficient to controvert the allegation of laches was properly considered, in effect, an admission of laches. In Gifford v. Travelers Protective Association, 153 F. (2d) 209 (C.A. 9), the plaintiff sued on a fraternal insurance policy. The defendant moved for summary judgment on the ground that the suit was brought beyond the time allowed by the articles of the association as incorporated in the policy. The movant introduced the articles of the association and a letter in which it had denied liability and rested. The court granted summary judgment. If there were any facts by which plaintiff might have avoided the result plainly indicated by the articles of the association, they were within plaintiff's knowledge, and not to be developed through cross-examination of the defendant. The trial court had given plaintiff extra time in which to plead any facts by which he could have avoided the contractual limitation, and his failure to do so was properly considered, in effect, as an admission of the truth of the movant's position.

Similarly, in Lawson v. American Motorists Ins. Corp., 217 F. (2d) 724 (C.A. 5), in a suit on an insurance policy, defendant pleaded that the plaintiff had not filed proof of loss within 100 days after discovery of loss as required by the contract. Plaintiff filed no counter-affidavits and the court found that the plaintiff's deposition made clear that he had never filed proof of loss. In the absence, then, of any facts (which, if they existed, were within the plaintiff's knowledge) satisfactorily explaining the failure to file, the court granted the summary judgment.

But where—as, e.g., in Fogelson v. American Woolen Co., and Bozant v. Bank of New York, supra—the facts asserted by movant are peculiarly within the knowledge of the movant, then the opponent must be given the opportunity to disprove that fact by cross-examination and by the demeanor of the movant while testifying. In such a case—a case like the one before us—the failure of the opponent to file a counter-affidavit has no significance. For, in his counter-affidavit, he could do no more than to say, "I hope, at a trial, by cross-examination and 'demeanor evidence' of movant's affiants when they testify orally, to persuade the trial court to disbelieve them." Such a paper would be no real affidavit and would not comply with Rule 56(e) since it would not be based on "personal knowledge" and would not "set forth such facts as would be admissible in evidence." As it would be merely the equivalent of his opposition to the entry of a summary judgment, it would be superfluous. So in Garrett Institute v. American University, 163 F. (2d) 265, 267 (App. D.C.), the court, reversing a summary judgment for plaintiff-appellee, said: "And although appellant has made no offer to show the existence of evidence in support of its denial and defense, and there may be some doubt as to the existence of a defense, still much, if not all, of appellant's defense depends on a cross-examination of appellee's documentary evidence, and we feel that since the defense is asserted in apparent good faith appellant is entitled to a trial which provides this opportunity to them. On the record as it stands, we cannot say that 'it is quite clear what the truth is.' "

Winkelman v. General Motors Corporation, 39 F. Supp. 826, cited by us with approval in Fogelson v. American Woolen Co., supra, goes to show the danger involved in granting a summary judgment for defendants in a derivative stockholders' suit on affidavits of defendants as to matters peculiarly within their knowledge. In the Winkelman case, after the judge denied summary judgment, the case went to trial and resulted in a judgment of some $7,900,000 (including interest) against these defendants (a judgment which was settled by the payment of $4,500,000).[9]

Of course, it is irrelevant that plaintiff owns but a few shares[10] (except upon a demand for security under the New York statute, a demand not yet made by defendants). Also irrelevant is the alleged fact, to which the district judge referred, that plaintiff is a competitor of Kayser. Nothing in the record so shows, but we shall assume, arguendo, that (as defendants assert) plaintiff's counsel so admitted in the court below. We assume, again arguendo, that this fact would have significance, if plaintiff's sole motive in suing were to aid his interest as competitor. Since, however, there was no such showing, we must take it that he was motivated at least in part by his stockholder interest. On that basis, his competitor-interest motive

9. These facts can be found in this court's record in Singer v. General Motors Corp., 136 F. (2d) 605 (C.A. 2).

10. Case v. Los Angeles Lumber Co., 308 U. S. 106, 116. Cf. The Code of Maimonides, Bk. IV, The Book of The Judges, (Transl. 1949) Ch. XX, Clause 10: "Think not that the foregoing rules apply only to a case involving a large sum of money to be taken from one [litigant] and given to the other. At all times and in all respects, regard a suit entailing one thousand maneh and one entailing a perutah as of equal importance."

must be ignored. See Beardsley v. Kilmer, 236 N. Y. 80; Aikens v. Wisconsin, 195 U. S. 194; Holbrook v. Morrison, 214 Mass. 209; (as to the difference between "disinterested malevolence" and mixed motives).

Defendants contend that to compel them to go to trial will involve them in considerable expense which would be avoided by the summary judgment. In the Fogelson case, supra, we rejected such a contention. There is no more reason why defendants in a stockholders' derivative action should be relieved of expense, through the avoidance of a trial, than in any other kind of suit where preparation for and conduct of a trial will involve considerable cost. The argument about defense expenses is particularly inapposite here since, under Section 61(b) of the New York General Corporation Law, defendants can demand and obtain from the plaintiff security for attorneys' fees and other expenses.

Count V alleges the approval of the contract by a vote at the stockholders' meeting of the holders of a considerable majority of the Kayser stock (which includes some 31% controlled by the controlling defendant-directors). Defendants urge that this approval serves as a complete defense. We do not agree, since, under the allegations of Count V, the defendant-directors who dominated and controlled Kayser's Board had conflicting self-interests.[11]

It is suggested that, as apparently the transfer of the Diamond assets to Kayser was completed after denial of

11. Geddes v. Anaconda Mining Co., 254 U. S. 590; Globe Woolen Co. v. Utica Gas & Elec. Co., 224 N. Y. 483; cf. Bowers v. Male, 111 App. Div. 209, 229, aff'd 186 N. Y. 28.

the preliminary injunction, a final injunction will serve no purpose, and therefore plaintiff, if he wins, can obtain no relief. To this suggestion there are two answers: (a) Should the ultimate decision go in plaintiff's favor, and should damages not constitute adequate relief, the court will require, by way of restitution, the undoing of the transfer of the assets from Diamond to Kayser if it has already occurred. It will be no bar to such restitution that the district court denied the preliminary injunction.[12] To be sure, such undoing of the transfer will require Diamond to act, and Diamond is not a party. But defendant Goldsmith controls Diamond, and the court can order him to cause Diamond to do the needful. (b) The complaint asks "for such other and further relief as may be just and proper." Accordingly, the court can award damages if they will afford adequate relief. See F.R.C.P. 54(c).

Defendants, in their brief and oral argument, made much of the reputations and characters of the individual defendants. Of course, we cannot consider any such factor: If, on a trial, it turns out that they did what they are charged with, their previous good behavior will not matter; on the other hand, at this stage of the case, we do not at all suggest that they did anything improper, for only after a trial can that be determined.

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12. Welton v. 40 East Oak Street Building, 70 F. (2d) 377, 381-382 (C.A. 7); Restatement of Restitution, Sec. 74; cf. Golde Clothes Shop v. Loew's Buffalo Theatres, 236 N. Y. 465, 470-471.

2. COUNT II

Count II rests entirely on Section 12(b) of the Securities and Exchange Act which relates solely to a contract made in violation of "any provision" of the Act or of "any rule or regulation thereunder." Here the contract itself was not thus violative. So that, even if the allegations stated a violation, the dismissal of this Count was correct.

3. COUNTS I, III AND IV

Counts I, III and IV rest on an alleged violation of a federal statute and regulation in connection with a proxy statement sent to stockholders of the Kayser Company. These Counts are substantially identical except that Counts III and IV are derivative while Count I is not.

As noted above, a majority of the court—for reasons stated in the separate opinion of Judge Medina—holds that the district judge, on defendants' motion, correctly dismissed each of these three Counts for failure to state a cause of action.

I concur as to Count I because I think that, quite aside from New York decisions[13] which do not govern here, such a claim must be asserted derivatively on behalf of the Kayser Company. I dissent as to the dismissal of Counts III and IV.

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13. See Schreiber v. Butte Copper & Zinc Co., 98 F. Supp. 106; Gordon v. Elliman, 306 N. Y. 446; Lehman v. Godchaux Sugars, Inc., N.Y.L.J., March 1, 1955, p. 7.

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4. Judge Frank's Dissenting Opinion, With Respect to the Dismissal of Counts III and IV.

I think the district judge erred in dismissing Counts III and IV. As they are substantially identical, I shall discuss Count III only. That court alleges violations of Section 14(a) of the Securities and Exchange Act as amended—15 U. S. C. Section 78n(a)—and of SEC Rule X-14A-9.

Section 14(a) reads: "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The SEC Rule reads: "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material facts, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

Count III alleges that the contract provided it would not be performed unless approved at a stockholders' meeting of Kayser; that, in advance of this meeting, the defendants solicited proxies and sent to each of the Kayser stockholders a proxy statement; and that this proxy statement violated Section 14(a) and the SEC Rule, in that (1) it contained statements which were false and misleading and (2) it "omitted to state material facts necessary in order to make the statements therein not false or misleading." It also alleges that the defendants knew of the respect in which the proxy statement was false and misleading, and knew of the omissions of material facts, and that the proxy statement was read by many stockholders of Kayser who were thereby mislead and induced to grant their proxies in favor of affirmance of the transaction at the stockholders' meeting and to vote in favor thereof at that meeting. It further alleges that the proxy statement was false or misleading in

(a) that it affirmatively but incorrectly stated that it fully described the direct and indirect self-interests of defendants Goldsmith, Feinberg and Hinerfeld, in the Kayser-Diamond contract, and

(b) that it omitted to state material facts, concerning their interests, which facts were "necessary in order to make the statements therein not false or misleading."

As to (a), the proxy statement did disclose this much of the self-interest of the three defendants: On or about May 13, 1954, three companies—Diamond, Hillcrest and

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Hamilton—each acquired about 10.4% of the Kayser stock; defendant Goldsmith controls Diamond, and defendant Feinberg and defendant Hinerfeld control Hillcrest and Hamilton; that Goldsmith, Feinberg and Hinerfeld are directors of Kayser. From this perhaps it may be fairly inferred that, as the complaint alleges, these three defendants control the Board of Directors of Kayser. So far, so good.

But Count III specifically alleges that the proxy did not disclose the following facts: In order to purchase these Kayser shares, those three companies had made loans, and, through the consummation of the Kayser-Diamond contract, Diamond would obtain funds which would be used to pay those loans.

My colleagues, however, surprisingly say that, although Count III does refer to those loans, yet "nowhere in the amended complaint is it alleged that such loans were made." I find it difficult to comprehend how my colleagues reach that conclusion. For Count III—in addition to the allegations above described, concerning the control by Goldsmith, Feinberg and Hinerfeld of both the seller, Diamond, and the buyer, Kayser—contains the following allegations:

"Diamond Hosiery Corporation (hereinafter called 'Diamond'), Hamilton Textile Mills, Inc. (hereinafter called 'Hamilton Textile') and Hillcrest Factors, Inc. (hereinafter called 'Hillcrest') are, upon information and belief, corporations duly organized and existing under and by virtue of the laws of the State of New York; on or

about May 13, 1954, each of said of corporations purchased 10.4% of the outstanding common stock of the defendant Kayser, to wit, 62,442 shares were purchased by Diamond, 62,443 by Hillcrest and 62,442 by Hamilton Textile. Defendants Goldsmith, Feinberg and Hinerfeld are variously officers and directors of defendant Kayser and variously officers, directors and controlling stockholders of Diamond, Hillcrest and Hamilton Textile.* * * [14] Said proxy statement omitted to state * * * The amount of money borrowed by Diamond, Hillcrest and Hamilton Textile to purchase the stock by Kayser, as aforesaid; the date or dates on which said corporations were required to repay such loans; and the portion of the purchase price to be paid by defendant Kayser to Diamond which will be used by Diamond, Hillcrest or Hamilton Textile respectively to repay such loans made by them for the purpose of acquiring the stock of defendant Kayser. * * * [15] Upon information and belief * * * the acquisition of said properties and assets will benefit defendants Diamond, Hillcrest and Hamilton Textile and Defendants Goldsmith, Feinberg and Hinerfeld * * * by enabling Diamond, Hillcrest and Hamilton Textile to acquire funds with which to pay for the stock of Kayser purchased by them, as aforesaid. * * * " [16]

This is not a mere "conclusory" allegation. It particularizes the violation of the Rule.

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14. See, in the Appendix to this opinion, amended complaint, paragraphs 5 and 6, incorporated by reference in Count III.

15. See amended complaint, paragraph 15(i), incorporated by reference in Count III.

16. See amended complaint, paragraph 14(b), incorporated by reference in Count III.

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This court, like other courts, has often held that allegations far less clear are adequate on a motion to dismiss.[17] Unless—despite the Federal Rules of Civil Procedure—we revert to the days when courts construed pleadings with what today courts consider unreasonable strictness, I fail to see why these allegations do not fairly advise defendants that plaintiff is asserting that these loans "were made." If I understand my colleagues, they would reverse the dismissal of Count III, if only, in addition to the allegations I have just quoted, plaintiff had inserted the words, "These loans were made."

I cannot concur in a ruling that the dismissal was correct for failure to insert those four words. That ruling ignores the host of decisions, in this Circuit and elsewhere, to the following effect: On a motion to dismiss a complaint, its allegations must be considered most favorably to plaintiff; as thus construed, they must be taken as true; a complaint should never be dismissed on motion unless it "appears to a certainty" that the plaintiff would be entitled to no relief under any set of facts which could be proved in support of the claim."

See, e.g., United States v. Employing Plasterers Association, 347 U. S. 186; Virgin Islands Corp. v. Taylor, 202 F. (2d) 61, 65; Package Closure Corp. v. Sealright Company, 141 F. (2d) 972, 978 (C. A. 2); Diogardi v. Durning, 139 F. (2d) 774 (C. A. 2); Callaway v. Hamilton National Bank of Washington, 195 F. (2d) 556, 559 (App. D. C.); Tiedeman v. Local 705, 180 F. (2d) 684, 686 (C. A.

17. See, e.g., 2 Moore, Federal Practice (2d ed.) pp. 2245-2246.

7); Kingwood Oil Co. v. Bell, 204 F. (2d) 8, 12-13 (C. A. 7); Mitchell v. Pilgrim Holiness Church, 210 F. (2d) 879, 881 (C. A. 7); Continental Collieries v. Shober, 130 F. (2d) 631, 635 (C. A. 3); King Edwards Employers F. C. U. v. Travelers Indemnity Co., 206 F. (2d) 726, 728 (C. A. 5); Knox v. First Security Bank of Utah, 196 F. (2d) 112, 117 (C. A. 10); Porter v. Karavas, 157 F. (2d) 984 (C. A. 10); 2 Moore, Federal Practice (2d ed.) pp. 2245-2246.

In Forstmann Woolen Company v. Murray Sices Corporation, 10 F. R. D. 367, 369, 370, Judge Medina said: "The Federal Rules of Procedure prescribe a simple method whereby claims and defenses may be stated. Rule 8, F. R. C. P. The rules, as construed, do not contemplate correction of inartistic pleadings by motion to strike, in the absence of some prejudice to the opposing party. See Moore's Federal Practice 2317-18 (2d ed., 1948). If the allegations attacked are such that under some contingency they may raise relevant issues, they will not be stricken. Moore, op. cit. supra, at 2318; see American Machine and Metals Co. v. De Bothezat Impeller Co., D. C. S. D. N. Y. 1948, 8 F. R. D. 306. * * * Of course, it is only necessary that the allegations constitute a statement of a claim upon which relief may be granted, see Dioguardi v. Durning, 2 Cir., 1944, 139 F. (2d) 774; Camrel Co. v. Skouras Theatres Corp., D. C. N. J. 1944, 57 F. Supp. 811, 812; and under the Federal Rules a pleading should not be dismissed unless it appears to a certainty that the pleader is entitled to no relief under any state of facts which could be proved in support of the claim. Moore, op. cit. supra, at 2245." [18]

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18. See also Judge Medina in Sebo v. United Airlines, 10 F. R. D. 327, 329.

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Opinion

The portion of the proxy statement relating to the interests of Goldsmith, Feinberg and Hinerfeld reads in its entirety as follows:

"A. Phillip Goldsmith a director of the Company is an officer and director of Diamond. Mr. Goldsmith and his associates, none of whom are directors or officers of the Company, own 75% of the issued and outstanding stock of Diamond. Diamond is the beneficial owner of 62,442 shares or approximately 10.4% of the issued and outstanding shares of Common Capital Stock of the Company.

"Abraham Feinberg, a director and Chairman of the Board of Directors of the Company, and Benjamin Hinerfeld, a director of the Company and its Executive Vice President, are each officers and directors, and, in conjunction with their associates, are the beneficial holders of a majority of the issued and outstanding stock of Hillcrest Factors, Inc. and Hamilton Textile Mills, Inc. respectively. Hillcrest Factors Inc. owns 62,443 shares or approximately 10.4% of the issued and outstanding shares of Common Capital Stock of the Company and Hamilton Textile Mills, Inc. owns 62,442 shares or approximately 10.4% thereof.

"Hamilton Textile Mills, Inc. is an affiliate of and Messrs. Feinberg and Hinerfeld are associates of the lessor under the Hamilton lease, above referred to, which lease was negotiated and entered into with Diamond as lessee in 1953 prior to the time that any of the persons named above in this caption became holders of the Common Capital Stock of the Company. Diamond, Hamilton

Textile Mills, Inc. and Hillcrest Factors Inc. became stockholders of the Company on May 13, 1954."

This statement omits any mention whatever of the facts about the loans. I think this omission, this non-disclosure, rendered the proxy statement violative of Section 14(a) of the Act and the SEC proxy Rule. For the provision of the Kayser-Diamond contract requiring the vote of the Kayser stockholders necessitated the issuance of a proxy statement complying with that section of the Act and that Rule. Because those three defendants controlled Kayser, they owed a fiduciary obligation to the other Kayser stockholders. See, e.g., Pepper v. Litton, 308 U. S. 295, 306; Geddes v. Anaconda Mining Co., 254 U. S. 590, 599; Sage v. Culver, 197 N. Y. 241, 247; Perlman v. Feldman, 219 F. (2d) 173 (C. A. 2). That fiduciary obligation, plus Section 29(a) and the Rule, made the omitted matter plainly material.

It follows that the proxy statement violated the statute and the Rule, because (a) it affirmatively stated that it fully disclosed all self-interests and thus contained a statement which was "false or misleading with respect to" a "material fact," and (b) it omitted to state material facts necessary to make it "not false or misleading."

Such a violation supports a civil action in a federal court. To be sure, Section 14(a) of the Act reads, "It shall be unlawful, etc." Other defendants, when sued civilly, under other similarly worded sections of this Act or the Securities and Exchange Act, have urged that such language does not authorize a civil suit by a private person. This court and other courts have refused to accept that

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argument. See Goldstein v. Groesbeck, 142 F. (2d) 422, 427 (C. A. 2); Fischman v. Raytheon Mfg. Co., 188 F. (2d) 783, 787 (C. A. 2), and cases there cited in note 4; Baird v. Franklin, 141 F. (2d) 238 (C. A. 2); Fratt v. Robinson, 203 F. (2d) 627, 632 (C. A. 9); Remar v. Clayton Securities Corporation, 81 F. Supp. 1014, 1017.

It has been suggested that the allegations do not satisfy F. R. C. P. 9(b) which requires that, in any "averments of fraud * * * the circumstances constituting fraud shall be stated with particularity." Since appellees did not raise this question in the district court or in this court, plaintiffs, if there were not a compliance with Rule 9(b), should be permitted to amend in this respect. But I think that Rule has no application here, since the claim in Count III is not for fraud but for violation of the statute and the SEC Rule. It has been held that a claim based on a similar statutory violation is not one for common law fraud, for the reason that some of the elements of such fraud need not be proved. Fischman v. Raytheon Mfg. Co., 183 F. (2d) 783, 786 (C. A. 2); Morris & Hirschberg v. S. E. C., 177 F. (2d) 228, 233 (App. D. C.); Hughes v. SEC, 174 F. (2d) 969, 975 (App. D. C.).

Moreover, I think that, if Rule 9(b) does apply, the allegations are specific enough to meet its requirements: For a violation of Section 14(a) and the SEC Rule, there may be either a civil suit or a criminal prosecution. Section 32(a) of the Act, 15 U. S. C. Sec. 78ff(a). If an indictment for such a violation contained the allegations of Count III above described, it would withstand a motion to quash, as those allegations are not only in the language

of the statute and the SEC Rule but go further and state particular facts sufficiently to advise the defendants of the charge against them. See, e.g., United States v. Achtner, 144 F. (2d) 49, 51 (C. A. 2); United States v. Kuchner, 135 F. (2d) 668, 673 (C. A. 2); Butzman v. United States, 205 F. (2d) 343, 348 (C. A. 6); Hagner v. United States, 285 U. S. 427, 430, 431; Wheeler v. United States, 77 F. (2d) 216, 218 (C. A. 9); SEC v. Time Trust, Inc., 28 F. Supp. 34, 42. If the allegations would suffice in an indictment in a criminal action, where a man's life or liberty is at stake, they must suffice in a civil complaint affecting merely defendants' property.

In Levenson v. B. & M. Furniture Co., 120 F. (2d) 1009 (C. A. 2), we said: "The petition at bar does not indeed allege the fraud with as much particularity as is desirable. But the omission is not fatal; it is only a pleading, and Rule 8(f) 28 U. S. C. A., following Section 723c, demands that it 'shall be so construed as to do substantial justice.' Its general purport is plain enough, and if the debtor had really any doubt about its meaning—which plainly it had not—it had, and still has relief under Rule 12(e); the day has passed when substantial interests stand or fall for such insubstantial reasons." See Gulf Western Oil Co. v. Trapp, 165 F. (2d) 343 (C. A. 10) where the court originally held (p. 347) the allegations insufficient, but on rehearing said (p. 351) that the allegations "set out the primary fundamental facts which, if true, would require the defendant to account. They furnish all necessary information enabling Trapp to refute them if they are untrue and to prepare his defense thereto." See also Perrott v. U. S.

Banking Corp., 53 F. Supp. 953 (D. C. Dela.): "While fraud must be alleged with particularity, it is only necessary to allege ultimate facts and not evidence." And see Mutual Life Ins. Co. of New York v. Krejci, 123 F. (2d) 495, 495 (C. A. 7); Daniel v. Board of Trade of the City of Chicago, 164 F. (2d) 815, 820 (C. A. 7); Kohler v. Jacobs, 138 F. (2d) 440, 443 (C. A. 5).

Defendants cite Judge Rifkind's opinion in Doyle v. Milton, 73 F. Supp. 281. There Judge Rifkind (p. 285) stated that there were two questions with respect to the proxy statement. The first he answered by showing that the SEC had filed a memorandum with the court stating that the proxy statement in that respect was not improper. The second question, as stated by Judge Rifkind, was whether a proxy statement is false or misleading which fails to state "that the management's proposal was conceived and planned to perpetuate the management's control of the corporation." In discussing this second question (p. 286), the judge said that the SEC proxy Rule does not require the statement of such a motive. I think this discussion by Judge Rifkind, in that context, has no bearing on question now before us: The undisclosed "motive" or purpose here was that the three principal individual defendants would bale their controlled companies out of a loan made to purchase the controlling stock of Kayser.

The district judge stressed the fact that members of the staff of the SEC—as distinguished from the Commission itself—made no objection to the proxy statement sent to the stockholders here. But those subordinates cannot bind

the Commission, and do not speak for it without its approval, not given here. More important, nothing in the record shows that the fact concerning the loan was disclosed to the Commission or its staff.

The district judge also said that plaintiff, if he had inquired, would have learned of the omitted material facts. What of it? If defendants had the obligation to insert the omitted matter in the proxy statement, it is no defense that plaintiff might have learned of that fact dehors the statement.

Accordingly, I think the allegations in Count III with reference to the loans should prevent its dismissal. I agree that the other allegations concerning other matters in the proxy statement do not make out a good cause of action. An order to strike those other allegations would have been proper. But defendants sought no such order and none was entered. Of course, that part of a complaint is defective does not justify dismissing the whole of it.

An economy like ours, which thrives on the fact that thousands of persons of modest means invest in corporate shares, will be poorly served if our courts regard with suspicion all minority stockholders' suits, and, therefore, out of a desire to discourage such suits, apply to them unusually strict pleading rules, thus tending to thwart judicial inquiries into the conduct of wrongdoing, controlling stockholders. The unfortunate consequence will be that those in control may be immunized from effective attacks on their misdeeds, and, as a result, the small investors will lose confidence in all corporate managements, the honest as well as the dishonest.

There is no proof that the present action is a so-called "strike" suit. But, even assuming it is, we should have in mind the following remarks by Professor Simpson of Harvard, in discussing the attitude that all such suits are of that character: "But it has not always been recognized that the litigant with a personal axe to grind may serve a definitely useful purpose. Minority stockholders' suits are often very expensive; the day of the dogged and litigious individual who will bankrupt himself to 'get his rights' seems over; if a Clarence Venner will pay lawyers' and accountants' and engineers' fees in the hope of personal profit, numerous small and impecunious stockholders may sometimes be saved from serious injustice. Such protection to the small stockholders is fortuitous, but it may be better than none. The divorce between corporate ownership and corporate control, now almost complete in many large business units, requires that courts of equity be alert to protect the interests of scattered ownership against personal profit-seeking on the part of those exercising centralized control and that minority owners be encouraged to be active in asserting their rights, as the only alternative to some administrative control by government of the internal affairs of large corporations."[19]

Reversed and remanded as to Count V; affirmed as to Counts I, II, III and IV.

Judge Brennan concurs as to Counts II and V.

---

19. Simpson, Fifty Years of American Equity, 50 Harv. L. Rev. (1936) 171, 190-191.

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APPENDIX

Plaintiff's Amended Complaint (omitting the exhibits annexed thereto) may be found in the Appendix to Plaintiff-Appellant's brief at pages 4 through 17 inclusive.

MEDINA, *Circuit Judge,* dissenting in part:

In this case we are split three ways. Judge Frank holds for affirmance of the dismissal of Counts I and II and for reversal and remand as to Counts III, IV and V. I would affirm the dismissal of all Counts; and Judge Brennan goes with Judge Frank as to Count V and with me as to Counts III and IV. We all agree that Counts I and II were properly dismissed. The upshot is that we affirm Judge Walsh's order dismissing Counts I, II, III and IV and reverse so much of his order as dismisses Count V, with remand for further proceedings in due course as to that Count. Except for the portion of this opinion which concerns the dismissal of Count V on motion for summary judgment, what I have to say represents the views of Judge Brennan and myself.

COUNTS I, II, III AND IV.

On July 22, 1954, an agreement was made between Julius Kayser & Co. and Diamond Hosiery Corp. by the terms of which Kayser was to purchase Diamond as a going business. In substance the agreement contemplated the merger of an old established firm with a rapidly expanding new one. There were included in the agreement elaborate provisions for the scheduling and transfer of numer-

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ous parcels of real property, leases, patents and patent applications, trade-marks, trade names and applications therefor; raw materials and supplies required the taking of a special inventory; numerous adjustments were provided for with respect to prepaid insurance, wages and salaries, including accrued vacation pay, taxes, rents, mortgage interest, prepaid advertising and promotion expense and similar matters; the agreement provided that unless a majority of the stockholders approved on or before September 15, 1954, either party had the option to cancel and terminate the transaction; the seller warranted that the net worth at the date of closing "will be no less than $900,000;" and the purchaser, in addition to the various amounts found to be due on inventory, adjustments and so on, was to pay cash in the amount of $353,051 and assume an unpaid principal balance of $389,500 on a certain mortgage indebtedness; Kayser was not to be burdened with other miscellaneous obligations. The stockholders' meeting was scheduled for August 20, 1954. Plaintiff, a competitor of Kayser, acquired his 100 shares of Kayser stock one week before the announcement of the merger agreement; and he brought this action a few days before the meeting, unsuccessfully applying for an injunction to prevent the consummation of the merger.

The amended complaint, for reasons which are far from clear, is divided into five Counts, the last four of which repeat and reallege in a bewildering manner certain selected paragraphs and groups of paragraphs of the first and other Counts. It is not even clear whether all, or only a few, or perhaps one, of the Counts are derivative. This

devious method of approach is probably due to difficulties relating to jurisdiction or perhaps to the security provisions of Section 61(b) of the New York General Corporation Law; but we shall not concern ourselves with such reasons as may lie behind this seemingly needless confusion. The substance of the first four Counts is the charge that the Proxy Statement sent out prior to the stockholders' meeting contained false and misleading statements, contrary to the requirements of SEC Rule X-14A-9, from which plaintiff spells out a substantive right to sue, relying on Sections 14(a) and 29(b) of the Securities Act. It is claimed that the fact that the Proxy Statement was prepared in consultation with the staff of the SEC, and in full compliance with the SEC Rules and Regulations as interpreted by the staff, is of no moment, as the Commission gave no formal approval nor was any adjudication made as to the sufficiency of the Statement and we agree that such participation in the preparation of the Proxy Statement by staff members of the SEC as may have taken place cannot affect the sufficiency as matter of law of the allegations of the complaint.

In limine it is at least doubtful that it was the intention of the Congress to create any substantive rights by the provisions of Sections 14(a) and 29(b) of the Security Act. We do not think the authorities cited in support of plaintiff's position on this point do more than affect supposedly analogous situations. We need not reach that point, however, as the allegations contained in the first four Counts are insufficient to state a claim for relief, even if it be assumed that the inclusion of false and misleading

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statements in the Proxy Statement would constitute a sufficient basis for enjoining the consummation of an otherwise proper and legal agreement of purchase and sale or the undoing of one already carried out.

The Proxy Statement is lengthy and sets forth in elaborate detail the terms of the proposal, including a copy of the agreement of purchase and sale, elaborate descriptions of the properties involved, the nature of the business of the two companies and the anticipated effect of the merger, supplemented by various financial statements, with explanatory notes. The business of Diamond is to be taken over as a going concern with its key employees, including A. Philip Goldsmith, its president and general manager. Under the title "Interest of Directors, Officers and Stockholders of the Company and Associates," the Proxy Statement discloses the interests of A. Philip Goldsmith, who with associates, owns 75% of the stock of Diamond, and those of Abraham Feinberg and Benjamin Hinerfeld, owners of a majority of the stock of Hillcrest Factors, Inc. and Hamilton Textile Mills, Inc. It therein appears that Diamond, Hillcrest and Hamilton each owns 62,442 or 62,443 or 10.4% of the stock of Kayser and that Goldsmith, Feinberg and Hinerfeld are directors of Kayser. It further appears that Hamilton and Feinberg and Hinerfeld are associates of the Hamilton lease to Diamond and that the large stockholdings above described were acquired on May 13, 1954.

The amended complaint alleges the purchase of the respective amounts of common stock of Kayser on May 13, 1954, by Diamond, Hillcrest and Hamilton Textile, that

Goldsmith, Feinberg and Hinerfeld are "variously officers and directors of defendant Kayser and variously officers, directors and controlling stockholders of Diamond, Hillcrest and Hamilton Textile;" and that "defendants Goldsmith, Hinerfeld and Feinberg dominate and control the board of directors of defendant Kayser and the management of said corporation through their control of Diamond, Hillcrest and Hamilton Textile, which said corporations are the controlling stockholders of defendant Kayser." This conflict of interest is substantially disclosed in the Proxy Statement, except for the characterization of control, which may be inferred from the ownership of the three blocks of 10.4% each of the Kayser stock.

Rule X-14A-9 prohibits solicitation by means of any proxy statement "containing any statement which, at the time and in the light of the circumstances under which it was made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false and misleading." Accordingly, the amended complaint purports to set forth a series of allegedly false statements and a series of alleged omissions.

The so-called false statements turn out to be nothing of the kind. Thus paragraph 4 of the amended complaint has a long, involved preliminary sentence which, when read carelessly, appears to charge that certain specified statements of fact in the Proxy Statement are false. But this is merely an impression; there is no such enumeration. The preliminary sentence does allege that the Proxy Statement "contained statements" which "were false and

misleading," and it continues "among others, statements contained under" certain headings such as "Summary of Proposals," "Description of Diamond" and so on. But the subdivision (a), which immediately follows, merely states that "said statements," without specifying them, were intended to represent "that (i) it would be to the advantage and interest of Kayser and its stockholders to acquire said properties and assets of Diamond," with more to the same effect. The whole paragraph is no more than a series of conclusory characterizations. Not a single specific part of the Proxy Statement is identified and alleged to be false. A similar paragraph might be contrived by an artful and ingenious pleader who knew nothing of the facts and had good and sufficient reasons for not taking the responsibility of making a serious charge as to any specific supposedly false statement, for fear of the consequences, should it develop that such specific statement was absolutely true.

The long enumeration of a host of alleged omissions in paragraph 15 of the amended complaint again boils down to nothing at all. Most of these alleged omissions are bits of miscellaneous information which plaintiff's knowledge of the business as a competitor appears to have made it possible for him to think up, although a Proxy Statement containing such a mass of detail would likely confuse more than help a stockholder. Thus information is said to have been omitted, such as the names of the Kayser officers who inspected Diamond's properties and reported thereon, the proportion of Diamond's backlog of hosiery orders for full-fashioned hosiery and for seamless hosiery, the ratio

of net earnings to net sales of Diamond for the four months ended June 30, 1954, the age of the machinery to be acquired by Kayser from Diamond (despite the description in the Proxy Statement of Diamond's "completely modern hosiery manufacturing plant"), and the reason why the agreement provided for cancellation of the agreement if Goldsmith died before a certain date.

The alleged omission which is principally relied upon is supposed to be "the amount of money borrowed by Diamond, Hillcrest and Hamilton Textile to purchase the stock of Kayser, as aforesaid; the date or dates on which said corporations were required to repay such loans; and the portion of the purchase price to be paid by defendant Kayser to Diamond which will be used by Diamond, Hillcrest or Hamilton Textile respectively to repay such loans made by them for the purpose of acquiring the stock of defendant Kayser." But nowhere in the amended complaint is it alleged that any such loans were made.

Judge Walsh properly held these allegations to be insufficient in law on their face. Otherwise a speculator or competitor interested in muddying the waters could attack any substantial proposed corporate transaction, *without knowing anything about it*, and harass the officers and directors of the contracting parties indefinitely with the taking of depositions and demands for the production of documents and admissions, and the answering of interrogatories.

COUNT V

This brings us to Count V which reads:

> "29. Plaintiff repeats and realleges as part of this cause of action each and all of the allegations contained in paragraphs 1, 2, 5-9 inclusive, 22, 23-26 inclusive and 28 of this amended complaint, with like effect as if herein fully repeated.
>
> 30. The amount in controversy exceeds, exclusive of interest and costs, the sum of $3,000.00."

This Count incorporates by reference: diversity of citizenship (1); plaintiff's ownership of 100 shares of Kayser stock (2); the purchase of Kayser stock by Diamond, Hillcrest and Hamilton Textile, the alleged control and conflicting interests of Goldsmith, Hinerfeld and Feinberg, a charge that the agreement was negotiated by Kayser "at the instigation and direction of" Goldsmith, Hinerfeld and Feinberg (5-9); an allegation that plaintiff brings the action "on behalf of himself and all other stockholders of defendant Kayser similarly situated" (22); allegations that a demand upon the Board of Directors to bring the suit would be futile in view of the control and the interest of Goldsmith, Hinerfeld and Feinberg, that the action is not collusive, that plaintiff has no adequate remedy at law (23-26); and an allegation that "said purchase would constitute an improper and wasteful expenditure of its funds, would be detrimental and injurious to it, and would be solely for the benefit of defendants Goldsmith, Hinerfeld, Feinberg and Diamond, Hillcrest and Hamilton Textile" (28).

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Opinion

This is the Count which was disposed of on the merits by the granting of defendants' motion for summary judgment.

Perhaps the most significant feature of the papers submitted in support of and in opposition to the motion for summary judgment is the complete failure of plaintiff to present any proofs whatever to establish his charges. The affidavit of counsel is no more than an argumentative memorandum. And so the proofs submitted in support of the motion remain unanswered.

The affidavits filed by defendants include one by the lawyer who prepared the Proxy Statement and who conducted the conferences with the SEC staff, one by the accountant who assisted at these conferences and another by Abraham Feinberg, a director and Chairman of the Board of Kayser. The details, including letters passing between counsel and the Assistant Director of the Division of Corporate Finance of the SEC, appearing in the affidavit of Emanuel Klimpl, demonstrate the scrupulous care with which the Proxy Statement was prepared. There was full disclosure of the conflict of interest upon which plaintiff relies so confidently; many of the supposed omissions were due to specific Regulations stating that such information was unnecessary; others were found upon consultation to be of little or no importance.

The Feinberg affidavit establishes in the most convincing manner that the purchase, far from constituting "an improper and wasteful expenditure" of the Kayser funds, and "detrimental and injurious to it," and "solely for the benefit of" Goldsmith and the other defendants, was in

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every way advantageous to Kayser, whose "business had steadily fallen off from an annual volume of $6,500,000 for the year 1949 to approximately $3,500,000 for the year ended June 30, 1954." The Kayser Hosiery Division had been operating at a loss. On the other hand, under the guidance of Goldsmith, who, by the way, stood to lose the most if the new set-up failed to live up to expectations, Diamond, with a modern, efficient, up-to-date plant and an aggressive and successful sales organization, had been making rapid strides ahead, in the face of a contrary trend in the industry as a whole.

Thus some of the advantages and benefits to Kayser were thus catalogued by Feinberg:

> "The addition of Diamond's $9,000,000 volume of business will result in a 50% increase in the gross volume of business done by Kayser.
>
> The addition of the Diamond business will treble Kayser's volume of hosiery business.
>
> Kayser will have as the active head of its Hosiery Division one of the most successful, outstanding figures in the industry.
>
> Kayser will acquire a topnotch merchandising and selling organization with which the Kayser hosiery staff can be integrated.
>
> Kayser hosiery products, now in the higher price lines under its 'Kayser' and its 'Christian Dior' brand names, will have added to them the Diamond 'Fruit of the Loom' and 'Custom-Pack' lines, which are in the lower, popular price ranges, resulting in a well rounded line in the branded and private label field.

Opinion

> On the basis of current operations of both companies, I have conservatively estimated that the absorption of the Diamond business into Kayser will make possible savings in factoring costs, overhead and finishing costs which, added to the Diamond current earnings, will add a minimum of $700,000 to Kayser's annual earnings, before taxes. This figure should go higher when overlapping in the two organizations is eliminated and when, as we are confident they will, the 'Kayser' and 'Christian Dior' Brand name sales increase.
>
> Along with a merchandise inventory consisting of newly manufactured hosiery, at the lower of cost or market value, we get the benefit of approximately $500,000 of unfilled Diamond orders."

If it be said that no appraisals of independent experts were submitted to prove that the value of the assets and properties purchased, including good will, were in excess of the purchase price, it is a sufficient answer to point out that the allegation in the original complaint that the amount paid was "in excess of the fair and reasonable value of such assets and properties" was omitted from the amended complaint. Moreover, under the circumstances and in the absence of any evidence whatever to the contrary, no such affidavits were required in any event. Nor was it necessary that defendants produce affidavits of each of the directors to the effect that they gave the matter independent consideration and voted approval of the transaction because they were convinced that it was a good purchase for a fair price in Kayser's interest.

The nub of the charge in Count V is not that the directors acted in bad faith or that their votes did not repre-

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sent their true views concerning the business advantages to Kayser, but that the "purchase would constitute an improper and wasteful expenditure of its funds, would be detrimental and injurious to it" and would be solely for the benefit of Goldsmith, Hinerfeld, Feinberg and their companies. Surely it cannot be the law that the purchase of a few shares of stock just prior to the consummation of a merger or similar corporate transaction of purchase and sale, involving large sums of money, can put the purchaser in a position to make charges of wasteful and improper expenditure of funds, leave such charges wholly unsubstantiated when defendants move on proper proofs for summary judgment, and then proceed to take advantage of the discovery procedures provided in the Federal Rules of Civil Procedure. Especially is this so, when, as pointed out in Judge Walsh's opinion below, the purchaser is a competitor.

For these reasons I would affirm Judge Walsh's order in its entirety, and I dissent from so much of the determination of this court as reverses and remands with respect to Count V of the complaint.

Judge Brennan concurs as to counts I, II, III and IV.

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Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 3rd day of June, One thousand nine hundred and fifty-five.

Present:

HON. JEROME N. FRANK,
" HAROLD R. MEDINA,
Circuit Judges

HON. STEPHEN W. BRENNAN,
District Judge.

DAVID L. SUBIN,
Plaintiff-Appellant,

—v.—

A. PHILIP GOLDSMITH, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

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Judgment

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed as to Counts I, II, III and IV and reversed and remanded as to Count V in accordance with the opinion of this Court; with costs to the appellant.

A. Danial Fusaro
Clerk

U. S. Court of Appeals
Second Circuit

Filed June 3, 1955

SEP 24 195
HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM—1955

No. 358

DAVID L. SUBIN,

Petitioner,

against

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & CO., a New York corporation,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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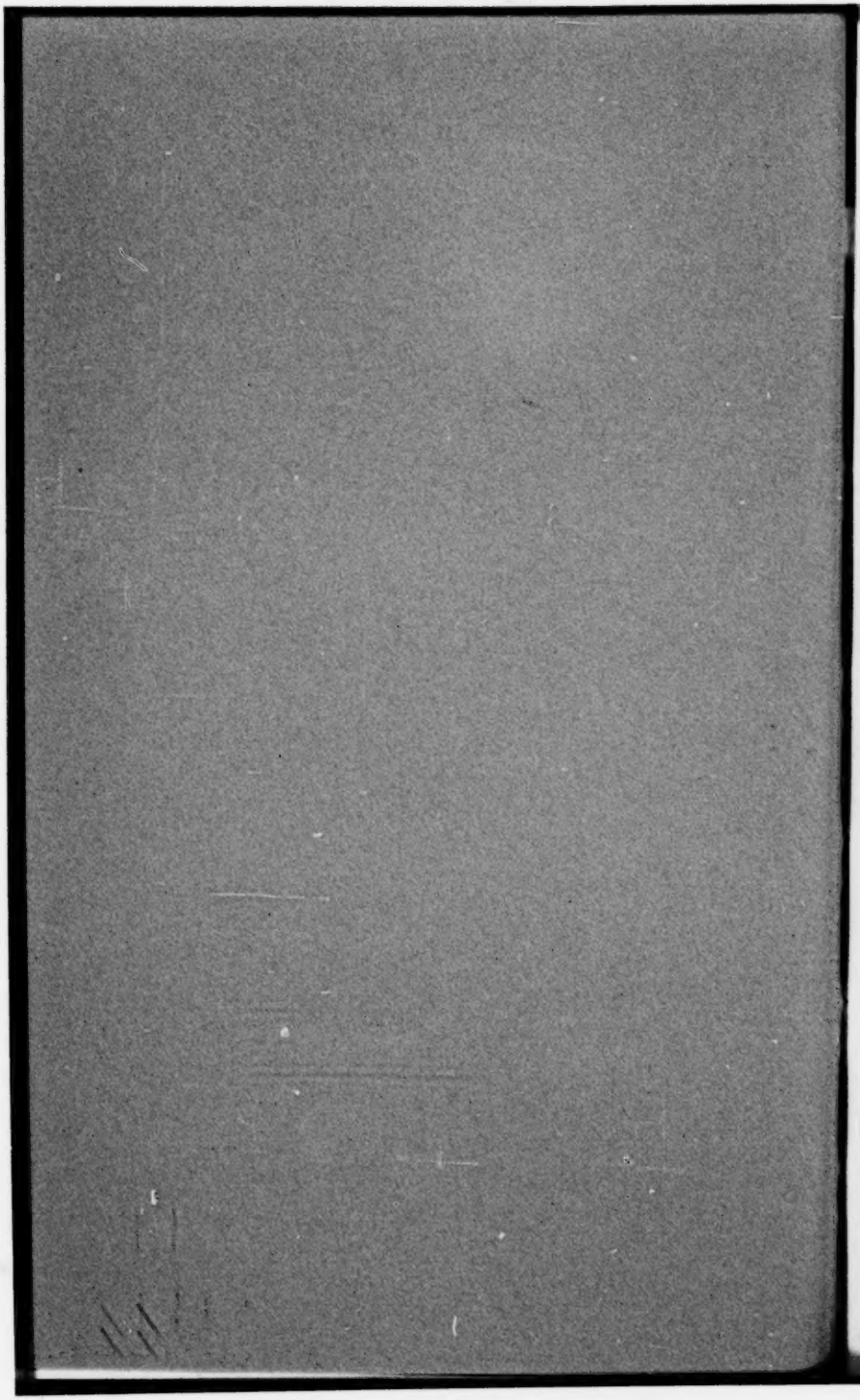

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IN THE

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OCTOBER TERM—1955

No. 358

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Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the District Court (R. 165-168, PA 40-P42)* is not officially reported. The opinion of the United States Court of Appeals is not yet reported. It is reprinted as an appendix to the Petition, pp. 14-56.

Jurisdiction

The jurisdictional requisites are adequately set forth in the petition.

Statute and Regulation Involved

The pertinent provisions of the Securities Exchange Act of 1934 (Title 15 U. S. C. §78n (a) ("The Act") and the

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* "PA" references refer to pages in document marked "Appendix of Plaintiff-Appellant".

regulation involved (Rule X-14A-9 of the Securities and Exchange Commission ("The Commission")) are set forth in the petition at page 3.

Question Presented

Was the alleged omission from the July 22, 1954 Proxy Statement of individual motives and of reference to the evidentiary fact that moneys paid by Kayser for the assets of Diamond would be used to liquidate certain personal obligations incurred by the purchase of Kayser stock a sufficient allegation of fact to state a claim for violation of Section 14(a) of the Act and, more particularly, Rule X-14A-9, even though the ultimate facts of conflicting self-interests were specifically delineated in said Proxy Statement.

Statement

A complete statement of the case and previous proceedings heretofore had is contained in the respondents' cross-petition for a writ of certiorari, docket number 362, October Term 1955, at pages 2 through 5.

The review sought by the petitioner herein is limited to the sufficiency of the allegations contained in Counts I and III of the amended complaint (PA 4-15); in particular, with respect to the statement of a claim under Rule X-14A-9 of the Securities and Exchange Commission and Section 14(a) of the Securities and Exchange Act of 1934 (petition, p. 1).

It is the petitioner's contention that the statements contained in the Proxy Statement **(D2a-D44a), to wit, all interests of the directors and officers had been disclosed (D12a), were false and misleading by virtue of the fact that the Proxy Statement failed to disclose that the proceeds of the sale of Diamond Hosiery Corp. ("Diamond")

** "D-a" references refer to pages in document marked "Appendix to Appellees' Brief".

would be used to pay certain obligations incurred by A. Philip Goldsmith ("Goldsmith") Abraham Feinberg ("Feinberg") and Benjamin Hinerfeld ("Hinerfeld") (petition, pp. 8-9). These obligations were allegedly incurred prior to the acquisition of the assets of Diamond by Julius Kayser & Co. ("Kayser") and any stock interest in Kayser by Goldsmith, Feinberg or Hinerfeld. It is not alleged that Kayser was a party to these loans or in any way affected or obligated by virtue thereof (PA 9-10). Similarly, it is contended that the omission of any mention of these loans and the disposition of the proceeds was an omission of a material fact, which, in light of the existing circumstances, was necessary to make the representations in the Proxy Statement "not false or misleading" under Rule X-14A-9 (petition, pp. 8-9).

Since the petitioner in his petition relies almost exclusively upon the omission of reference to these alleged loans, this being the only factor of substance found by Judge FRANK in his dissent below (petition, p. 43), it is assumed that all other grounds and supposed deficiencies stated in the amended complaint have been abandoned.

A copy of the Proxy Statement was appended to the amended complaint (PA 18-33), incorporated within the pleading by reference (PA 6, 7, 8, 9), and before the Court on the respondents' motion to dismiss under Rule 12(b)(6) F. R. C. P. for failure to state a claim. The majority in the Court below (petition, pp. 45-52) and the District Court (PA 40-42) found, in essence, that the omission of reference to whether or not the persons purchasing shares of Kayser stock borrowed some monies to finance part of the purchase, when read in light of the other facts pleaded by the petition (i.e., description of interests of the directors and officers) and contained in the annexed Proxy Statement was not actionable at law.

In short, the question determined by the Court below and presented by the petitioner is: Whether the failure to set

forth certain facts, from which a personal motive of less than a majority of the directors might be gleaned and having no direct relationship to the transaction involving the stockholders or the Corporation, states a claim for relief under Rule X-14A-9.

ARGUMENT

I

The decision below is correct.

(a) Counts I and III were properly dismissed for failure to state a claim (re: Question 1).

It is undisputed that the Proxy Statement disclosed that Goldsmith, Feinberg and Hinerfeld beneficially acquired 31.2% of the capital stock of Kayser on May 13, 1954; that Goldsmith was a director of Kayser and effectively controlled Diamond, the company to be acquired; that Diamond had entered into a lease as lessee with a corporation controlled by Feinberg and Hinerfeld, who were similarly officers and directors of Kayser; and, that this lease was to be assumed by Kayser (D12a-D13a). The net effect of this transaction, as characterized by the District Court, was "* * * a defensible merger of an old established firm with a rapidly expanding new one." (PA 42).

If it be assumed, *arguendo*, as petitioner assumed though he did not so allege,[1] that certain loans were made by Gold-

1. "Said proxy statement omitted to state material facts necessary in order to make the statements therein at pages 2-6 thereof * * * not false or misleading; among other things, said proxy statement omitted to state (or set forth): (i) The amount of money borrowed by Diamond, Hillcrest and Hamilton Textile to purchase the stock of Kayser, as aforesaid; the date or dates on which said corporations were required to repay such loans; and the portion of the purchase price to be paid by defendant Kayser to Diamond which will be used by Diamond, Hillcrest or Hamilton Textile respectively to repay such loans made by them for the purpose of acquiring the stock of defendant Kayser."

smith, Feinberg and Hinerfeld to acquire their beneficial stock interest in Kayser, the omission of reference thereto did not render the Proxy Statement defective under Section 14(a) of the Act or Rule X-14A-9 of the Commission's Regulations. The Proxy Statement disclosed by clear inference the ultimate fact that all proceeds would enure to the sole benefit and unfettered use of the individuals whose conflicting self-interests had previously been disclosed. The petitioner contends that the failure to particularize the specific use of the proceeds (i.e., liquidation of implied private loans incurred by the purchase of Kayser stock), which at best would be mere evidence of the already disclosed ultimate fact of self-interest, was the omission of a material fact rendering the Proxy Statement false or misleading (petition, pp. 8-9).

A statement of motive was not required under the existing law of *Doyle* v. *Milton*, 73 F. Supp. 281, 286 (D. C. S. D. N. Y., 1947), and not required by the staff of the Commission during their informal, but exhaustive, examination and analysis of the submitted and distributed Proxy Statement. What disposition was made of these funds, whether used to pay an obligation incurred to purchase Kayser stock; or used to pay any other obligation; or used to donate to a worthy charity is of no importance to the stockholders or the corporation itself. Any such disclosure of motive or a specific use or uses of the proceeds over which Kayser no longer had any interest or control would at best be the disclosure of an evidentiary fact from which the ultimate fact of self-interest "might reasonably" be inferred. Herein lies the weakness of the petitioner's position—for it is undenied that the stockholders were adequately forewarned by full disclosure in the Proxy Statement of the existence of the ultimate fact of conflicting self-interest. As long as this duality of interests was disclosed; the stockholders fairly acquainted with the terms of the proposed transaction; and, the transaction was for full and adequate consid-

eration and beneficial to Kayser, the disposition of the proceeds is utterly without significance—for neither the Corporation nor the stockholders were parties thereto or affected in any manner thereby.[2]

To require as a matter of law that proxy statements in addition to the ultimate fact of self-interest must disclose all motivations of the directors which might enter into a proposed transaction is to cast an insufferable burden upon the Commission, without the scope and intent of the Act. The petitioner argues for a rule of law which would require the Commission in every proxy and registration solicitation to conduct exhaustive investigation into the private affairs of all corporate officials in quest of some hidden motive which should stand the scrutiny and light of public disclosure. The Commission has never required such disclosure (see *Doyle* v. *Milton, infra*). For the courts to superimpose such an *ad hoc* legislative requirement upon the Commission, without unequivocal statutory language or affirmative administrative request, would seriously delay and hamper the effective administration of the Act. Determining motivation is at best a tenuous, psychologically calculated guess based upon extensive examination and analytical evaluation of the various economic, social or political factors impinging upon the individual at the specific time of action. To require the Commission analytically to sift these innumerable factors and require affirmative delineation of any and all motives moving the individual would appear to be presumptive, economically unsound, administratively burdensome and without the scope and intent of both the Act and the Commission's Rules.

The District Court, in *Doyle* v. *Milton,* 73 F. Supp. 281, 286 (D. C. S. D. N. Y., 1947), in considering whether the

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2. Cf. *Dunn* v. *Decca Records,* 120 F. Supp. 1, 2 (D. C. S. D. N. Y., 1954); *Doyle* v. *Milton,* 73 F. Supp. 281, 286 (D. C. S. D. N. Y., 1947).

omission of an alleged hidden motive of the defendants to perpetuate control of the management of the Corporation and thereby further their own personal interests to the detriment of the plaintiff and all other stockholders constituted a defect in the Proxy Statement under Section 14(a) of the Act and Regulation X-14, held that a Proxy Statement is not rendered false or misleading by the omission of selfish motives.

Judge RIFKIND, in dismissing such allegations of motive as insufficient in law, said (p. 286):

> "The statute, §14(a) of the Securities Exchange Act of 1934, confides in the Securities and Exchange Commission very broad rule making powers with respect to proxy solicitation. The Commission has promulgated such a regulation, X-14. That regulation does not in terms require the inclusion of statements as to motive.
> * * *
>
> "The upshot of these reflections is that a court ought not to rush in where the experts fear to tread. At any rate I think it more prudent not to anticipate the Commission's determination that the proposed course is both feasible and in the public interest. Until the Commission speaks my answer to the second question (inclusion of motive within a Proxy Statement) is No." (parenthetical language supplied)[3]

(b) The Court could determine that the Proxy Statement was not false or misleading, upon the facts alleged in the amended complaint, as a matter of law (re: Question 2).

By Question 2 the petitioner raises the point whether a complaint alleging fraud by omission, along with other fac-

3. Also see: *Textron, Inc.* v. *American Woolen Co.*, 122 F. Supp. 305, 310 (D. C. Mass., 1954), where failure to disclose alleged wrongful intent was not considered an omission rendering the Proxy Statement false or misleading under Rule X-14A-9.

tors indicating the surrounding circumstances, can be dismissed as a matter of law for failure to state a claim under Rule 12(b)(6) F. R. C. P. It is the petitioner's contention that the Court below erred in dismissing Counts I and III as a matter of law. Petitioner's reasoning is as follows: (a) it was alleged that certain facts were omitted; (b) that these omissions were the omissions of material facts necessary not to make the Proxy Statement false or misleading; (c) upon a motion to dismiss it must be assumed that these allegations were true; (d) therefore, a claim under Rule 8(a) was stated; (e) and, this claim survives a motion to dismiss under Rule 12(b)(6).

The fallacy of the petitioner's reasoning is twofold. Initially, he errs in the assumption that pleaded conclusions of law and his characterization of the Proxy Statement stand admitted. The allegations that the omissions were material and that the inclusion of these omissions was necessary to make the Proxy Statement not false and misleading under Rule X-14A-9 (the alleged conclusions of law and deductions of fact) are not admitted for the purposes of a motion to dismiss.[4] Similarly, the petitioner fails to recognize that the entire Proxy Statement, appended to the amended complaint and incorporated by reference into the pleading as Exhibit A, was before the Court on the respondents' motion under Rule 12(b)(6). Reference by the Court to this Statement was not the reference to extraneous matter without the borders of the pleading—but reference to the pleading itself. *St. Louis, K. & S. E. R. Co.* v. *United States,* 267 U. S. 346, 45 S. Ct. 245, 69 L. Ed. 649 (1925).

The Court, in dismissing Counts I and III, and the Court below in affirming, were duty bound to look to the entire pleading and in its total light determine if these omissions

4. 2 Moore, Federal Practice (2d ed., 1953), ¶ 12.08, p. 2244, and cases cited.

could, under any facts proved by the petitioner, support a claim for relief under Rule X-14A-9 (i.e., could these omissions from the Proxy Statement reasonably be material facts necessary in order to make the Proxy Statement not false or misleading). The Court below did not decide adversely to the petitioner an issue of fact (i.e., whether the omissions were in fact material); but rather decided that the sum of the facts as pleaded were legally insufficient, in light of the other facts contained in the Proxy Statement and incorporated in the pleading by reference, to show that a legal wrong could have been committed.[5]

II

There is no important question of Federal law presented.

In effect, the petitioner is calling upon this Court to interpret and apply, to the particular factual situation presented, Rule X-14A-9, promulgated pursuant to Section 14(a) of the Act. Section 14(a) of the Act is a general delegatory provision allowing the Commission to establish the rule under which the petitioner alleges violation. Hence, the interpretation and question involved concerns a rule of the Commission and only indirectly the Act itself.[6]

In answer to the petitioner's contention that a substantial question of Federal law exists, it is respectfully submitted that though the Commission's own Rule is in issue, the petitioner neither sought redress through the Commis-

5. See *St. Louis, K. & S. E. R. Co.* v. *United States*, 267 U. S. 346, 45 S. Ct. 245, 69 L. Ed. 649 (1925); *Kordewick* v. *Brotherhood of Railroad Trainmen*, 181 F. 2d 963 (7 Cir., 1950); *Leggett* v. *Montgomery Ward & Co.*, 178 F. 2d 436 (10 Cir., 1949).

6. It is generally recognized that Congress by Section 14(a) of the Act left the solicitation of proxies to the Commission's discretion under broad "public interest" standards. See Loss, Securities Regulation (1951), pp. 523-524, and authorities cited therein.

sion nor has the Commission, though fully advised and informed by the *respondents* of all charges instituted and proceedings heretofore had, seen fit to intervene in any manner whatsoever. If the questions presented, as alleged by the petitioner, are of such a substantial nature as he would have this Court believe, it is difficult to imagine that the administrative agency which promulgated this Rule and, is (1) chargeable with the proper administration of its Rules and the Act; and, (2) is fully familiar with both the Proxy Statement as distributed and the charges made by the Petitioner, should stoically maintain a consistently indifferent attitude throughout the entire proceedings coursing through the District and Circuit Courts.[7] This contrasts markedly with the situation presented in other similar cases where, though the legal contest was between private litigants, the Commission considered the issues involved of sufficient importance to file briefs as *amicus curiae*.[8]

Though it is not contended that the lengthy and detailed conferences with the staff of the Commission with respect to the Proxy Statement has the force of a pre-judicial administrative determination,[9] surely this factor, when considered with the fact that the Commission was fully in-

7. Cf. *Securities and Exchange Commission* v. *O'Hara Re-election*, 28 F. Supp. 523 (D. C. Mass., 1939).

8. E.g., *Doyle* v. *Milton*, 73 F. Supp. 281 (D. C. S. D. N. Y., 1947).

9. But cf. *Dunn* v. *Decca Records, Inc.*, 120 F. Supp. 1, 2 (D. C. S. D. N. Y., 1954); *Peck* v. *Greyhound Corp.*, 97 F. Supp. 679 (D. C. S. D. N. Y., 1951). "Copies of proposed proxy material are required to be filed with the Commission in preliminary form at least 10 days prior to the date of the proposed solicitation. Where preliminary material fails to meet the disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to avoid such defects in the preparation of the definitive proxy material." (19th Annual Report of the Securities and Exchange Commission (1953), p. 33).

formed as to the extent and nature of the petitioner's charges, is *dehors* the contention that a substantial question of Federal law is now presented for this Court to determine.[10]

The weakness of the Petitioner's position is further evidenced by his reliance on *Wilko* v. *Swan*, 346 U. S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953) as authority to show, by a parity of reasoning, that the instant case presents an important question at Federal law affecting the Act. The *Wilko* case, in which the Commission participated as *amicus curiae* throughout the entire proceedings, involved a fundamental interpretation of Sec. 14 of the Securities Act of 1933 (15 U. S. C., Sec. 77n), which declares void a waiver of any provision of the Securities Act of 1933 or the Commission's Regulations. It was contended that an arbitration clause in a margin agreement prevented the aggrieved purchaser from relying on the remedies of the Securities Act of 1933. A determination of whether the provisions of the Securities Act of 1933 prohibiting any waiver could be circumvented by the inclusion of such an arbitration clause, thereby obviating the remedies of that Act, was basic to the future existence of Sec. 14 of the Securities Act of 1933. To allow such indirect avoidance of these provisions would effectively sterilize and render nugatory the provisions forbidding a waiver.

Contrasting the fundamental problem of interpretation in the *Wilko* case with the instant situation, it cannot be contended that Rule X-14A-9 has been decimated and rendered ineffectual in future proxy solicitations. The prohibition of false or misleading statements remains, *proprio vigore*, as

10. It is safe to assume that if the Commission considered petitioner's charges substantial and producing violations of its own Rule X-14A-9, some formal administrative action to correct the supposed deficiency would have been instituted (i.e., request Kayser to issue a supplemental Proxy Statement and postpone the scheduled meeting).

before, to be applied to every pending and future fact pattern presented in a proxy statement. The determination by the Court below, that no violation of Rule X-14A-9 was stated by this petitioner does not and will not assist in determining the existence of a false or misleading statement in any other situation. For, whether a set of facts contained in a complaint, incorporating therein a proxy statement, states a claim for relief, or is violative of Rule X-14A-9, depends upon the particular circumstances presented.

III

There is no existing conflict of decision among the lower courts. The decision below does not affect any substantial amount of future litigation.

(a) There is no existing conflict.

The lack of importance of the case *sub judice* is highlighted by the complete failure of the petitioner to cite any authority even remotely connected with the question herein presented. There are no existing conflicts among the several Courts of Appeals; or, in fact, among their constituent District Courts.

(b) The decision below does not affect any substantial amount of pending or future litigation.

It is not contended, nor indeed can the petitioner contend, that the decision by the Court below affects any substantial amount of pending or future litigation. True, the petitioner resorts to the familiar and spurious argument of "horribles" and contends that the principles of *Pepper* v. *Litton*, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939) have been emasculated by the decision below (petition, p. 11).[11] But the fact remains that the petitioner cannot point to any pending or past administrative action or litigation

11. "* * * But the court below has adopted such a narrow standard as to vitiate the doctrine announced in Pepper v. Litton, 308 U. S. 295 and to render the proxy rules useless as an instrument for protecting stockholders. * * *"

even remotely connected with the issues he now seeks to have this Court review. Similarly, it is not seriously urged by the petitioner that the decision below affects the orderly administration of the Act involved or is contrary to any established policy of Congress or the Commission itself.

A determination by this Court will not affect any other litigants in any other comparable litigation now pending or to be instituted. The petitioner has proceeded under Rule X-14A-9, which is the general "catch-all" provision prohibiting false or misleading statements, having its genesis in common law fraud and deceit. Under Rule X-14A-9, and an essential element to establish common law fraud, it is necessary to show materiality of the alleged omission, in light of the particular circumstances pleaded. Any determination by this Court must be predicated strictly upon the specific Proxy Statement involved and pleaded in the complaint. A simple reference to the existing case law decided under Rule X-14A-9 indicates that any determination as to the materiality and sufficiency of the facts pleaded to constitute a claim for relief is *sui generis*.[12]

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12. See *Textron, Inc.* v. *American Woolen Co.*, 122 F. Supp. 305, 310 (D. C., Mass., 1954) (failure to disclose alleged wrongful intent did not make the Proxy Statement false or misleading); *Dunn* v. *Decca Records*, 120 F. Supp. 1, 2 (D. C. S. D. N. Y., 1954) (failure to disclose additional pecuniary remuneration to the president did not render the Proxy Statement false or misleading); *Kerbs* v. *California Eastern Airways*, 94 A. 2d 217, 219 (Del. Ch., 1953) (failure to inform stockholders of lack of quorum under state law because of existing self-interests of the directors was not an omission rendering the Proxy Statement false or misleading); *Kaufman* v. *Shoenberg*, 91 A. 2d 786 (Del. Ch., 1952) (failure to refer to existing incentive compensation for key employees who were to receive further incentive benefits by the proposed plan for which the proxies were solicited was not an omission of a material fact); *Eliasberg* v. *Standard Oil Co.*, 23 N. J. Super. 431, 444, 92 A. 2d 862, 868, 869 (1952), aff'd 12 N. J. 467, 97 A. 2d 437 (failure to disclose inherent tax benefits to officers and directors and correlative tax disadvantages to corporation under proposed stock option plan was not a material omission).

Hence, instead of deciding a question of great and pressing importance in the affairs of the nation tending to promote the consistent and orderly administration of justice throughout the country, a determination by this Court would merely determine whether the omissions of certain loan data from which a motive "might" possibly be inferred from the July 22, 1954 Proxy Statement of Julius Kayser & Co. was the omission of a material statement necessary to make that specific Proxy Statement "not false or misleading"; and whether the statement that the interests of the directors were fully disclosed was false or misleading. No amount of strained semantics can enlarge the scope of the real questions now presented. The Commission, which informally examined the Proxy Statement prior to distribution and has been fully apprised of the petitioner's allegations has not seen fit to take any action. In addition thereto, two Courts have considered the problems and found that the petitioner failed to state a claim. Only one, out of a total of four judges who have considered this question at length in the two lower Courts, found merit to the petitioner's claim under Count III. There was complete unanimity in dismissing Count I. The petitioner, not yet convinced, now seeks to obtain review here.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari be denied.

Respectfully submitted,

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Counsel for Respondents

September 23, 1955.

FILED
AUG 30 195
HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM—1955

No. 362

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & CO., a New York corporation,

Cross-Petitioners,

against

DAVID L. SUBIN,

Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, WITH APPENDIX

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IN THE

Supreme Court of the United States

OCTOBER TERM—1955

No.

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & Co., a New York corporation,

Cross-Petitioners,

against

DAVID L. SUBIN,

Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner herein prays that a writ of certiorari issue to review that part of the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on June 3, 1955 reversing and remanding in part the decision of the District Court, with respect to Count V of the amended complaint.

Opinions Below

The opinion of the District Court (*R. 165-168, †P40 to P42) is not officially reported. The opinion of the United States Court of Appeals is not yet reported. It is reprinted as an Appendix to the original petition of Subin, respondent herein, pp. 14-56.

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* All "R" references refer to pages of the Record.

† All "P" references refer to pages of Plaintiff-Appellant's Appendix.

Jurisdiction

The judgment of the Court of Appeals was entered on June 3, 1955 and is reprinted at pp. 57-58 in the original petition of Subin, respondent herein. The jurisdiction of this Court is invoked under 28 U. S. C. §1254 (1).

Question Presented

Where plaintiff in a derivative stockholders' action submits no affidavit in opposition to the defendants' motion for summary judgment, either to substantiate the allegations of fraud made upon information and belief, or to challenge the facts of the movants' affidavit, negating and completely controverting all allegations of fraud, must summary judgment nevertheless be denied and the defendants compelled to proceed to trial on the sole basis of the plaintiff's claimed right to cross examine as to credibility and demeanor of the unchallenged affiant.

Statute Involved

The pertinent statutory provisions of Rule 56, Federal Rules of Civil Procedure are set forth in the Appendix, *infra,* p. 1a.

Statement

On July 22, 1954 Julius Kayser & Co., one of the petitioners herein (hereinafter referred to as "Kayser") entered into an agreement with Diamond Hosiery Corp. (hereinafter referred to as "Diamond"), subject to approval of the shareholders of Kayser (**D13a), by which it

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** All "D—a" references refer to pages of Defendants-Appellees' Appendix.

acquired the profitable, functioning organization and business of Diamond, including manufacturing facilities, purchase orders, inventories and certain licenses and leases necessary for the operation of the Diamond property (D15a to D29a). The aggregate cash involved was approximately $1,725,000; the assumption of a ten year mortgage obligation totaling $389,500; and the duty to discharge certain contractual obligations incident to the assets, licenses and lease acquired (D17a to D19a). Diamond's valuable good will, trademarks and profitable licenses were acquired for the nominal sum of One Dollar (D5a, D18a). The inventory, which was completely current and against which there were purchase orders of at least $500,000, was purchased at the lower of cost or market (D4a, D18a). In addition, Kayser acquired the services of personnel who had made Diamond a unique and highly successful hosiery concern. Though Kayser has been in the hosiery business since 1890, during the past few years its volume has steadily declined. During the fiscal year ending June 30, 1954, its hosiery volume was approximately one-half that of Diamond (D10a). Conversely, Diamond had operated at an increased volume, rising from $1,400,000 in 1949 to $7,900,000 during the fiscal year ended February 28, 1954 (D8a). The products manufactured by Diamond are in a low price field and do not conflict with but complement the established lines of hosiery produced by Kayser, thus giving it a completely diversified line of products in all price fields (D10a).

A Notice of Meeting and Proxy Statement, to secure stockholder approval as provided in the agreement, was issued to all shareholders of July 22, 1954 (D1a to D44a), and disclosed that A. Philip Goldsmith, one of the petitioners (hereinafter referred to as "Goldsmith") owned or controlled 75% of the stock of Diamond, and was an officer and director of that corporation; a director of Kayser; and that Diamond was the beneficial owner of approximately 10.4% of the stock of Kayser. Similarly it

was reported that petitioners, Abraham Feinberg (hereinafter referred to as "Feinberg"), a director and Chairman of the Board of Kayser, and Benjamin Hinerfeld (hereinafter referred to as "Hinerfeld"), a director and Executive Vice President of Kayser, owned or controlled a majority of the stock of Hillcrest Factors, Inc. (hereinafter referred to as "Hillcrest") and Hamilton Textile Mills, Inc. (hereinafter referred to as "Hamilton"), respectively. These organizations each controlled, and it was so indicated in the Proxy Statement, 10.4% of the stock of Kayser. It was further disclosed that Hamilton, Feinberg and Hinerfeld were associated with the lessor under a certain existing lease subsequently assumed by Kayser and executed by Diamond, as lessee, in 1953. This lease antedated the date Diamond, Hamilton, and Hillcrest acquired any stock interest in Kayser, which was May 13, 1954 (D12a to D13a).

After inspection of the assets; favorable recommendation by a subcommittee of the Board of Directors, the latter consisting of 11 members; and a finding that the purchase would be highly beneficial to Kayser and its stockholders, the Diamond contract was approved by the directors of Kayser, subject to stockholders' ratification (D10a to D11a, D13a). Neither Goldsmith, Hinerfeld nor Feinberg voted at the Board meeting at which the Diamond acquisition was discussed and approved. The Board's action was therefore completely independent (D57a). Diamond's fixed assets were acquired at 25% below their depreciated book value and well below the independent appraisals fixed by an independent engineering firm specializing in hosiery plants (D11a). Copies of the evaluations were before the Board of Directors at the meeting at which they voted to approve the Diamond contract and were available for inspection by any interested shareholders of Kayser and the Proxy Statement so stated (D11a).

The respondent and cross-petitioner (hereinafter referred to as "plaintiff"), a competitor of Kayser, purchased his 100 shares of stock one week before the an-

nouncement of the purchase of Diamond by Kayser; but after he knew Goldsmith, Feinberg and Hinerfeld had acquired control of 31.2% of the stock of Kayser and had been elected to its Board of Directors (D59a). On August 6, 1954, the plaintiff's attorneys wrote Kayser requesting extended data (D62a to D63a), to which Kayser replied promptly. Plaintiff declined to avail himself of Kayser's proffer to supply him with pertinent data; nor did the plaintiff attempt to examine the independent appraiser's report and other materials available at the company's office (D48a to D49a). Instead, on August 13, 1954, several days before the special meeting of stockholders called to approve the Diamond purchase, he commenced suit by Order to Show Cause seeking a preliminary injunction to restrain the meeting and alleged fraud, waste and mismanagement. He also charged the Proxy Statement was violative of Sections 14 and 29 of the Securities and Exchange Act (R. 1-35). This application for a preliminary injunction was denied by Judge WALSH (D60a to D63a). At the meeting duly held on August 20, 1954, the Diamond contract was approved by approximately 92% of the shareholders (455,199 for—43,389 against) (D65a).

At the hearing on plaintiff's motion for a preliminary injunction, defendants made a cross-motion to dismiss the complaint under Rule 12(b)(6), Federal Rules of Civil Procedure (R. 69-70). Thereafter, and before determination of the cross-motion, plaintiff served an Amended Complaint (P4 to P36). Defendants then moved under Rules 12(b)(6) and 56, F.R.C.P., to dismiss the first four counts (violations of the Securities and Exchange Act) and for summary judgment as to the fifth count (traditional derivative shareholders' count) (D64a to D65a). The District Court granted this relief *in toto* (P40 to P43), whereupon plaintiff appealed to the United States Court of Appeals for the Second Circuit. The District Court's determination was affirmed as to Counts I, II, III, and IV, Judge FRANK dissenting in part; and reversed and remanded as to Count V, Judge MEDINA dissenting (Appendix to Subin petition, pp. 14-56).

Reasons for Granting the Writ

1. Initially, it is respectfully submitted, the holding in the case *sub judice* is expressly predicated upon the assumption that the uncontroverted and unchallenged affidavit submitted by the movants completely controverted the plaintiff's allegations of fraud, waste and mismanagement. It is therefore clear that this holding is not based upon any insufficiency of the moving papers. Judge FRANK, speaking for the majority, expressed this thought, as follows (Appendix to Subin petition, p. 19):

> "We shall assume, arguendo, that Feinberg's affidavit, if taken as true, completely controverted the allegations of Count V. But we have held that, in such a derivative stockholders' suit—especially as to facts peculiarly within the knowledge of the defendants—plaintiff is entitled to a trial at which he may cross-examine the defendants and at which the trial judge can observe their demeanor in order, thereby, to evaluate their credibility."

In essence the majority has held, in the instant case, that in a stockholders' action in which fraud is alleged the affidavits of the defendants are disregarded, even though they completely controvert the plaintiff's unsupported allegations of fraud, alleged in his complaint upon information and belief, and irrespective of plaintiff's failure to submit any affidavit sufficient under Rule 56(e). This decision of the court below is directly in conflict with the decisions of the Tenth Circuit Court of Appeals in *Brooks* v. *Utah Power & Light Co.*, 151 F. 2d 514 (10 Cir., 1945); *Lopata* v. *Handler*, 37 F. Supp. 871, 873 (D. C. Okla., 1941), *app. dsmd.* 121 F. 2d 938 (10 Cir., 1941); and The Third Circuit Court of Appeals in *Dickheiser* v. *Penn. R.R.*, 5 F.R.D. 5, 10 (D. C. Pa., 1945), *aff'd* 155 F. 2d 266 (3 Cir., 1946), *cert. den.* 329 U. S. 808, 67 S. Ct. 620 (1947); also see *Wise* v. *Universal Corp.*, 93 F. Supp.

393 (D. C. Del., 1950); where, in granting the defendant summary judgment in a derivative stockholders' action alleging fraud, it was declared to be the avowed purpose and function of Rule 56 to pierce the allegations of the pleadings and require the plaintiff to "condescend upon particulars". Similarly, this decision is in conflict with the principles enunciated in *Brensinger* v. *Margaret Ann Super Markets*, 192 F. 2d 458 (5 Cir., 1951) (fraud action); *Sabin* v. *Home Owners' Loan Corp.*, 151 F. 2d 541 (10 Cir., 1945) (fraud in part); *Lindsey* v. *Leavy*, 149 F. 2d 899 (9 Cir., 1945), *cert. den.* 326 U. S. 783, 66 S. Ct. 331 (1946) (conspiracy alleged); *Geller* v. *Transamerica Corp.*, 53 F. Supp. 625 (D. C. Del., 1943), *aff'd* 151 F. 2d 534 (3 Cir., 1945) (fraud alleged).

This conflict has been recognized and expressed by Judge BRENNAN, one of the judges composing the majority in the court below, in *Bishop* v. *Shaughnessy*, 119 F. Supp. 62, 65 (D. C. N. D. N. Y., 1950), as follows:

> "To attempt to reconcile these decisions would be to undertake an onerous task, and it is doubtful if the conclusion would serve the purpose of complete clarification. If clarification is needed, it should come from an appellate court."

The clear intent of Rule 56, of which this Court is the final arbiter among the several federal Courts of Appeals and their constituent District Courts, is to permit speedy and expeditious disposition of litigation where no substantial genuine issue of a material fact is presented. The mere raising of a formalized issue or a conclusory averment in a pleading does not raise a substantial, genuine issue of fact. Rule 56 permits the Court to pierce the formal allegation and grant summary relief when it appears from the uncontroverted facts set forth in the affidavits that no genuine issue of fact exists. *Schreffler* v. *Bowles*, 153 F. 2d 1, 3 (10 Cir., 1946), *cert. den.* 328 U. S. 870, 66 S. Ct. 1366 (1946); *Wilkinson* v. *Powell*, 149 F. 2d 335, 337 (5 Cir., 1945); *Richard* v. *Credit Suisse*, 242 N. Y. 346, 350,

152 N. E. 110 (1926), per CARDOZO, *J.*; also see 6 MOORE, FEDERAL PRACTICE (2d ed., 1953), ¶ 56.04(1), p. 2028, *et seq.* and cases cited.

Where a party moves for summary judgment under Rule 56, it is incumbent upon the movant to present by affidavit, deposition or other authorized media, a prima facie showing that he is entitled to the relief sought. After this initial burden has been shouldered by the movant it remains for the opposing party to adduce some evidentiary facts, sufficient under Rule 56(e), to controvert the movant's offer and establish the existence of a disputed material issue of fact. *Marion County Cooperative Assn.* v. *Carnation Co.*, 214 F. 2d 557, 561, 562 (8 Cir., 1954); *Gifford* v. *Travelers Protective Assn. of America*, 153 F. 2d 209 (9 Cir., 1946); *Surkin* v. *Charteris*, 197 F. 2d 77 (5 Cir., 1952).

The majority in the instant case, after accepting the fact that the movants' affidavit completely controverted the plaintiff's allegations, attempts to justify its position by the creation of an inferential issue of credibility based upon the movants' unchallenged affidavit (Appendix to Subin petition, p. 19). It is respectfully submitted that, though demeanor and credibility might constitute real evidence at a trial, it can scarcely exist *in vacuo*. It is incumbent upon the plaintiff to show some substantive evidentiary facts—any facts—in support; and put the movants' affiants' credibility in issue. The plaintiff herein has shown nothing to detract from the credibility of these affiants. See *Byrnes* v. *Mutual Life Ins. Co. of N. Y.*, 217 F. 2d 497, 501 (9 Cir., 1954), *cert. den.* 348 U. S. 971, 75 S. Ct. 532 (1955); *Dyer* v. *MacDougall*, 12 F.R.D. 357, 358 (D. C. E. D. N. Y., 1951), *aff'd* 201 F. 2d 265, 268, 269 (2 Cir., 1952); *Orvis* v. *Brickman*, 95 F. Supp. 605, 607 (D. C. D. C., 1951), *aff'd* 90 App. D. C. 266, 196 F. 2d 762 (D. C. Cir., 1952); 6 MOORE, *op. cit.* ¶ 56.15(4), at p. 2142.

It is respectfully submitted that in the cases cited by the Court, e.g. *Fogelson* v. *American Woolen Co.*, 170 F. 2d 660

(2 Cir., 1948); *Colby* v. *Klune*, 178 F. 2d 872 (2 Cir., 1949); *Bozant* v. *Bank of New York*, 156 F. 2d 787 (2 Cir., 1946) some proof and affidavits sufficient under Rule 56(e) were submitted by the opposing party to prevent the suffering of summary judgment. These opposing affidavits set forth evidentiary facts from which the inferential fact of credibility could be drawn. In the instant case there has been no submission of any evidentiary fact from which it might be inferred that the credibility of the movants' affiants is in issue.

If the majority's holding is sound, a feigned and formal allegation of fraud in a complaint is sufficient to prevent summary judgment. Rule 56 is thus converted into an *ad hoc* duplication of Rule 12; and, though no exception appears to be so made in the Federal Rules of Civil Procedure, is completely inoperative in this type of litigation. Such a holding is in clear conflict with *Brooks* v. *Utah Power & Light Co.*, 151 F. 2d 514, 516 (10 Cir., 1945); *Dickheiser* v. *Penn. R.R.*, 5 F.R.D. 5, 10 (D. C. Pa., 1945), *aff'd* 155 F. 2d 266 (3 Cir., 1946), *cert. den.* 329 U. S. 808, 67 S. Ct. 620 (1947); *Lopata* v. *Handler*, 37 F. Supp. 871, 873 (D. C. Okla., 1941), *app. dsmd.* 121 F. 2d 938 (10 Cir., 1941); *Wise* v. *Universal Corp.*, 93 F. Supp. 393 (D. C. Del., 1950); where summary judgment was granted though fraud, waste and mismanagement were alleged in a derivative shareholders' action.

2. The majority in the instant case further held that the failure of the plaintiff to submit any affidavit to controvert the movants' affidavits was not sufficient grounds to grant summary judgment when the facts were within the peculiar knowledge of the movants(Appendix to Subin petition, p. 27).

It is difficult to rationalize the reasoning of the Court in reaching such a conclusion. Assuming *arguendo* that the rule be different where a *plaintiff* has peculiar knowledge of all of the facts and circumstances relating to the issues

involved and moves for summary judgment against a factually devoid *defendant*, it is illogical to apply such a rule where the *defendant* moves for summary judgment. See: *Orvis* v. *Brickman*, 90 App. D. C. 266, 196 F. 2d 762 (D. C. Cir., 1952) (Summary Judgment for defendants in false imprisonment action on defendants' affidavits); *Surkin* v. *Charteris*, 197 F. 2d 77 (5th Cir., 1952) (Summary Judgment for defendant in negligence action on unopposed affidavits); *Brensinger* v. *Margaret Ann Super Markets*, 192 F. 2d 458 (5th Cir., 1951) (Summary Judgment for defendant in fraud action based on defendants' unopposed affidavits); *Wise* v. *Universal Corp.*, 93 F. Supp. 393 (D. C. Del., 1950) (Summary Judgment for defendants in stockholders' derivative action based on defendants' affidavits); *Crosby* v. *Oliver Corp.*, 9 F.R.D. 110, 112 (D. C. Ohio, 1949). It is to be expected, and especially is this true in a derivative shareholders' action, where the complaint must be verified under Rule 23(b), that the plaintiff have some reasons and grounds to allege fraud, waste and mismanagement, other than mere aromatic speculation. The plaintiff has alleged *upon knowledge and belief*, in Paragraph 28 of the Amended Complaint (P16):

> "* * * said purchase would constitute an improper and wasteful expenditure of its funds, would be detrimental and injurious to it, and would be solely for the benefit of defendants Goldsmith, Hinerfeld, Feinberg and Diamond, Hillcrest and Hamilton Textile * * *."

The defendants' motion for summary judgment is the proper method to require the plaintiff to expand upon these allegations and specify the particulars upon which he relies to sustain his cause. If the plaintiff is not required to particularize his reasons and facts upon which he bases these allegations of fraud, waste and mismanagement, Rule 56 fails to accomplish its purpose as the method used to pierce the formal allegations of the complaint.

The plaintiff herein, by his own intransigence, refused to gather and voluntarily denied himself any information with respect to the Diamond contract. There existed as he knew, certain independent appraisals relating to the assets to be acquired. This information was on file and available for inspection by the plaintiff and any other interested shareholder (D11a). Plaintiff refused, by his own inaction, to avail himself of this data. Similarly, when plaintiff first expressed his objections to the transaction, an offer was made by Kayser to provide him with any information he might require (D48a to D49a). Plaintiff's answer to this proffer of information, was the institution of suit, claiming, *on information and belief*, the overvaluation of the very assets whose worth, as assessed by independent expert examiners he refused to inquire as to or examine (P9). Surely it cannot, therefore, be claimed, in good faith, that all of the facts concerning the worth of the acquired assets were *peculiarly* within the knowledge of the defendants.

The fact that the affiants, the individuals who had knowledge of the facts within the contemplation of Rule 56(e), were "interested" in no way detracts from the factual and persuasive import of their statments. This factor of interest does not, in and of itself, create an issue of credibility. *Chesapeake & Ohio Ry. Co.* v. *Martin*, 283 U. S. 209, 216-217, 51 S. Ct. 453 (1931); *Kuykendall* v. *United Gas Pipe Line Co.*, 208 F. 2d 921, 923, 924 (5 Cir., 1953); *Dewey* v. *Clark*, 86 U. S. App. D. C. 216, 180 F. 2d 766, 770 (D. C. Cir., 1950); *Surkin* v. *Charteris*, 197 F. 2d 77 (5 Cir., 1952); *Compania de Remorque y Salvamento* v. *Esperance, Inc.*, 187 F. 2d 114 (2 Cir., 1951).

3. The decision in the instant case is in conflict with other decisions by different panels of judges in the same Circuit. It has long been recognized that a fundamental divergence of opinion exists among various panels in the Second Circuit Court of Appeals with respect to the applica-

tion, interpretation and utilization of Rule 56. See: ASBILL & SNELL, *Judgment Under the Federal Rules—When an Issue of Fact Is Presented*, 51 Mich. L. Rev. 1143, 1151-1152 (1953), 5 Vand. L. Rev. 607, 611-612 (1952); 6 MOORE, *op. cit.* ¶ 56.15(1), at page 2106, *et seq.*

A decision by the Second Circuit is not so much a determination based upon the principle of *stare decisis* as upon the constituency of the panel composing the Court at a particular moment. There coexists in the Second Circuit, side by side, two diametrically opposed philosophies, decisions, and rules of law; neither view recognizing, attempting to distinguish, explain, or overruling the other. Compare *Arnstein* v. *Porter*, 154 F. 2d 464, 470-471 (2 Cir., 1946); *Colby* v. *Klune*, 178 F. 2d 872, 873, 874 (2 Cir., 1949); *Fogelson* v. *American Woolen Co.*, 170 F. 2d 660 (2 Cir., 1948) with, *Engl* v. *Aetna Life Insurance Co.*, 139 F. 2d 469, 472 (2 Cir., 1943); *Dyer* v. *MacDougall*, 201 F. 2d 265, 268, 269 (2 Cir., 1952); *Radio City Music Hall* v. *United States*, 135 F. 2d 715, 718 (2 Cir., 1943); *Compania De Remorque y Salvamento* v. *Esperance, Inc.*, 187 F. 2d 114, 117 (2 Cir., 1951).

Little need be said with respect to the intolerable and confused state of limbo in which both the practicing Bar and the District Courts of the busiest Circuit of the nation are thrown. We respectfully submit that this intracircuit confusion and "panel warfare" should be resolved by this Court.

4. The intent and meaning of Rule 56 is in a state of confusion by virtue of the decision in the instant case. The issue herein involved concerns many individuals and proceedings now pending and a substantial amount of future litigation in the District Courts. By the decision herein, a certain panel of the Second Circuit Court of Appeals has effectively sterilized the utilization and salutory purpose of Rule 56; and, except possibly in the case where the issues can be resolved by documentary evidence, the Court has

equated the function of Rule 56 to that of Rule 12. It is clear that though Count V of the Amended Complaint may possibly state a claim for relief under Rule 8(a) and thus not be subject to dismissal under Rule 12; when a motion for summary judgment under Rule 56 is made, the mere statement of a claim does not determine the motion. *Lindsey* v. *Leavy*, 149 F. 2d 899 (9 Cir., 1945), *cert. den.* 326 U. S. 783, 66 S. Ct. 331 (1946); *William J. Kelly Co.* v. *Reconstruction Finance Corporation*, 172 F. 2d 865 (1 Cir., 1949).

The plaintiff cannot claim an issue as to a material fact merely by virtue of a verified Complaint, upon information and belief, simply because he is convinced the affiants are telling untruths under oath. Surely the plaintiff should be armed with some facts before he charges reputable businessmen with fraud, waste and mismanagement. For example, upon what does the plaintiff base his claim that certain machinery to be acquired from Diamond was in excess of its true worth—surely not upon the independent expert appraisals plaintiff refused to examine.

5. The vice of the decision below is to allow the plaintiff to run a course contrary to the public policy as established in both the Federal and State jurisdictions. The underlying philosophy incidental to the promulgation of such statutory provisions as Section 61-b, New York General Corporation Law (security for costs), and Rule 23(b), F.R.C.P., is to protect the corporation from litigation based upon unsubstantiated, vague accusations of wrong by a dissident minority. To allow a minority shareholder, who fails to challenge the defendants' affirmative controversion of fraud, waste and mismanagement to proceed to trial upon a perfunctory formalized allegation of fraud, unsupported by a scintilla of evidence, is contrary to established public policy. See *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 69 S. Ct. 1221 (1949); *Shielcrawt* v. *Moffett*, 294 N. Y. 180, 62 N. E. 2d 392 (1945). It was in recognition of these principles that the New York Supreme Court, Appellate Division, First Department established Trial Term Rule

XI, subd. 6, which requires that the plaintiff-shareholder in a derivated stockholders' suit affirmatively show "special circumstances" before being allowed even to examine the defendants before trial.

6. **Summary:** The issues herein presented are of immediate and continuing importance to the proper disposition of a substantial amount of pending and future litigation in the District Courts. There is confusion and a clear split of authority exists between the decisions of the Tenth Circuit and Third Circuit Courts of Appeals and the holding in the instant case, e.g. *Brooks* v. *Utah Power & Light Co.*, 151 F. 2d 514 (10 Cir., 1945). An irreconcilable intracircuit split prevails in the Second Circuit Court of Appeals preventing the application of any consistent rule of law in a summary judgment situation. These issues can only be resolved by a clear determination and definitive ruling by this Court.

CONCLUSION

For the foregoing reasons this cross-petition for certiorari should be granted.

Respectfully submitted,

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Dated: August 26, 1955.

APPENDIX

Excerpts from Federal Rules of Civil Procedure

"RULE 56. SUMMARY JUDGMENT

* * *

"(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

* * *

"(e) Form of Affidavits; Further Testimony. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence and shall show affirmatively that the affiant is competent to testify to the matters stated therein.
* * *

* * *

OCT 3 1955
HAROLD B. WILLEY, C

IN THE

Supreme Court of the United States

October Term, 1955

No. 362

A. PHILIP GOLDSMITH, ABRAHAM FEINBERG, BENJAMIN HINERFELD, F. STAFFORD CLEARY, J. A. C. MUELLER, T. H. MUELLER, J. J. MURPHY, WILLIAM B. TERRY, G. H. CARR and JULIUS KAYSER & Co., a New York corporation,

Cross-Petitioners,

—against—

DAVID L. SUBIN,

Respondent.

RESPONDENT'S BRIEF

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32 CASE PRESS, 30 Ferry Street, N. Y. C.—COrtlandt 7-0484-0485

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—against—

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Respondent.

RESPONDENT'S BRIEF

1. In their cross-petition defendants give the impression (pp. 2, 6, 8) that this is a case of an application for summary judgment based on affidavits which disposed of the contentions in the complaint and were entirely unanswered by plaintiff. Such, however, is far from the case. The motion for summary judgment was here incidental to plaintiff's motion for an injunction based on his own affidavit and the affidavits primarily relied on by defendants were submitted in opposition to the injunction motion.

Plaintiff's affidavit amplified the complaint in at least one important respect. For he pointed out (Reply App. p. 2) that the machinery to be acquired manufactured only "full fashioned" hosiery which was a glut on the market, whereas "seamless" hosiery which is in great demand had

to be purchased from outside sources. If that is so, grave doubt is cast on the claim of defendants that the acquisition of Diamond's machinery would benefit Kayser. That issue alone would have to await a trial.

The only affidavit by any person having knowledge of the facts, defendant Feinberg, made no attempt to deal with all the charges in the complaint, but was directed primarily at persuading the Court not to grant an injunction.

Thus the affidavits relied on by defendants did not contain a word refuting paragraph 14(b) of the complaint [Pltff.'s App. p. 8] (incorporated by reference into the fifth count [Pltff.'s App. p. 16]), which states that the acquisition of the Diamond property will benefit that company and the other controlling stockholders of Kayser (Hillcrest and Hamilton), as well as Goldsmith, Feinberg and Hinerfeld, by permitting Diamond to withdraw from the hosiery business, where it operated at a diminishing rate of profit under unfavorable leases (which leases Kayser will take over in the contracts).

Nor is there anything to refute the charge that the business of Diamond, which operated at a continually reduced ratio of profit, would not contribute to the profitable operations of Kayser. Nor is there anything to refute the charges that the trademarks to be obtained from Diamond would not be useful to Kayser for the reasons alleged in the complaint.

Significantly, the affidavits do not contain one word to refute the charges concerning the borrowing by defendants, their urgent need to complete the transaction for

personal and selfish motives, the secret substitution of directors, as well as the other matters charged in the complaint.

The motion for summary judgment should, therefore, have been denied because defendants' papers were insufficient. The judgment of the court below can be sustained on that ground without the necessity for considering any of the side issues.

2. The conflict alleged (pp. 6, 7) to exist with other Circuits is illusory. For, as we have shown, defendants' affidavits do not "completely controvert" the complaint and plaintiff has submitted an affidavit which, in part at least, supports his complaint.

Nor do the cases establish any conflict. Thus, *Brooks* v. *Utah Power & Light Co.*, 151 F. 2d 514 (cited p. 6) holds only that no fraud had been shown under the circumstances there disclosed, which bear no resemblance whatever to the case at bar. The same observation is true of most of the cases cited by defendants.* Particularly inapt is the citation of *Wise* v. *Universal Corp.*, 93 F. Supp. 393, for there, at page 398, the court noted plaintiff's failure, despite a lapse of twenty months, to have taken the depositions of defendants to show that the statements made by them were not correct. For in the case at bar plaintiff never had such an opportunity, the motion for summary judgment having been made 12 days after the service of the complaint and 2 days after the filing of the amended complaint (See Pet. App., pp. 1, 2). The *Lindsey* case

* Indeed, some merely hold the complaint insufficient on its face: *Bresinger* v. *Margaret Ann Super Markets*, 192 F. 2d 458; *Sabin* v. *Home Owners' Loan Corp.*, 151 F. 2d 541.

(149 F. 2d 899) involved an attack on a conviction; defendants proved their case by court records.

3. Likewise there is no basis for the suggestion that there is any conflict within the Second Circuit itself. One would suppose that the decisions to which defendants call attention (p. 12) were rendered by two different sets of judges. But that is not the case. Judges Learned Hand, Swan, Chase and Frank all concurred in both sets of cases. One can but conclude that those judges believed that the facts of the particular cases called for differing results. There is, therefore, no such "intolerable and confused state of limbo" as is stated by defendants.

We respectfully suggest, therefore, that the cross-petition be denied.

Respectfully submitted,

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Counsel for Respondent

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IRWIN KARP
of Counsel